Caribbean Mergers and Acquisitions:

Country Studies of the Financial Sectors of Guyana, Jamaica and Trinidad and Tobago

Glenn A. Khan

Caribbean Centre For Monetary Studies

About the Author

Mr. Glenn A. Khan is a Research Fellow at the Caribbean Centre for Monetary Studies. He holds a graduate degree in Economics from the University of the West Indies, St. Augustine, Trinidad and Tobago. He has a background in the Commercial Banking Sector and has also worked at the Ministry of Finance, Trinidad and Tobago. Some of his other publications are in the areas of Development Banking, Financial Development and the Credit Union Sector.

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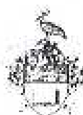

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Preface and Acknowledgements

Prior to reading this document readers should note that the manuscript was completed in October 1999. Review by financial sector practitioners as well as academic peers and policy-makers has delayed its publication. Because of the time which has elapsed between writing and publication, very little information on recent merger activity is contained in the book.

We predicted that mergers would intensify in the new millennium and recent events have confirmed this. In July 2001, public disclosure was made of the intention of CIBC West Indies Holdings and Barclays Bank PLC to merge their retail, offshore and corporate operations in the Caribbean to create a megabank, First Caribbean International, with an asset base of over US$10 billion. In St. Lucia, the merger between the National Commercial Bank and St. Lucia Development Bank was consummated on July 01, 2001. The Royal Bank of Trinidad and Tobago has continued its cross-border acquisitions. Its purchase of the Union Bank in Jamaica was completed in March 2001 at a cost of approximately TT$ 196 million, and it has made a number of additional purchases in the Dutch territories. In Jamaica, Finsac is currently engaged in an attempt to sell its shareholding in NCB Jamaica following a December 2000 reorganisation of that entity and its return to profitability. In Guyana, we understand that consideration is to be given to the divestment of the Guyana National Cooperative Bank. What is undeniable is that Caribbean merger activity has intensified in 2001. In the Credit Union sector, an area where there is an over supply of providers, we expect to see significant merger and acquisitions activity in the decade up to 2010. This is, in our view, inevitable. The market simply cannot sustain the number of service providers. The need to satisfy customer requests should force weaker units into merging with stronger ones or there will be failure. There is little doubt that these are interesting times for the financial sector.

I have benefitted from the advice, comments, technical assistance and support from a number of persons and institutions. First, I would like to thank the former Executive Director of the Caribbean Centre for Monetary Studies, Laurence Clarke, who suggested that this research be pursued. It has been a very rewarding exercise

for me personally and I hope that the output meets his satisfaction. The Chief Executive Officers and some senior executives of all the institutions engaged in merger activity made themselves available for discussion and also provided financial reports. This document would not have been possible without their support, as well as that of the former executives of the merged institutions. Mr. Peter Salvary of C.L. Financial is owed special thanks because he was able to provide information not contained in books, but in the recesses of his memory. Messrs. Philip Rochford and Osborne Nurse, former CEOs of NCB and Workers Bank (1989) Ltd. Trinidad and Tobago, deserve special mention. These gentlemen reviewed the entire document and also met for consultation. Their intimate knowledge of those institutions proved critical in the completion of the section on Trinidad and Tobago. Professor Simon Jones-Hendrickson of the University of the Virgin Islands acted as an academic reviewer. He undertook this assignment whilst engaged in providing technical support to the Government of St. Kitts and Nevis. I am grateful for his assistance. Dr. Daniel Boamah and Mr. Colin Bullock, of the Central Bank of Barbados and Bank of Jamaica respectively, also read the document and provided critical comments. Among colleagues at the Centre, useful discussion was engaged in, but I am deeply indebted to Mrs. Pamela Joseph who was burdened with typing the entire document. She displayed great patience and always responded when called upon to deliver. I am also grateful to Ms. Gloria Lawrence who prepared the text in publication format. There are many other persons who contributed to the completion of the document either by providing information and/or suggestions. I wish to convey my special thanks to all of them. I accept responsibility for any remaining errors and absolve them from blame.

Introduction

In the 1970s and 1980s it was commonplace to hear people refer to the banking sector, insurance sector or even the financial sector. Nowadays the term *financial services industry* seems to be accepted nomenclature. What does this portend for the future and what does it suggest about changes that have come about? Perhaps it is linked to the radical transformation of the industry, promoted to a large extent by rapidly evolving technological changes. It suggests, too, that traditional ways of doing business with financial institutions will give way to more sophisticated relationships. Chiefly responsible for these events is the globalisation of the financial services industry. The latter, in particular, has instigated mergers on a scale and size previously unmatched.

In these fast changing and sometimes uncertain economic times, the success of business, even economies, depends on strategy, and for many firms, mergers and acquisitions appear to be the strategy being pursued to achieve the critical mass necessary to retain or gain a competitive advantage. Whitford (1997) has suggested that companies of all shapes and sizes are facing the business climate equivalent of 100-year storms. Further, that deregulation has turned entire industries completely upside down; media companies, advertising companies, banks, insurance companies are all frantically trying to adapt to the new reality - heft has become enormously important. It has been suggested that the strategy of economic power is similar, in many respects, to that of military power; attack is the best form of defence. To expand one's company is the most certain way of preserving or increasing one's market share. The size of the organisation, therefore, becomes the important consideration.

The fundamental changes occurring over the last decade, especially deregulation of the financial services industry and financial liberalisation, have forced institutions to recognise the importance of strategic alliances. In order to achieve those goals,

the strategy of many firms has been to consolidate in the hope of achieving synergies. Such actions have been nowhere more pronounced than in the financial services industry, though not exclusive to it. The Caribbean is no exception. The RBTT Financial Holdings Limited, incorporated in Trinidad and Tobago, comprises thirty-three subsidiaries and associate companies located in eleven jurisdictions in the region, including nine commercial banks, one merchant bank, one trust company, one development bank, one stockbroking company, and a substantial interest in three insurance companies. It is by far the most well-known financial services provider throughout the Caribbean.

The eve of the 21st century is an appropriate time, and hopefully it is not too late, to ponder the question of the appropriateness of our banking systems and whether we need to strengthen them for possibly difficult times ahead. Of course, we need to strengthen our financial system, perhaps through mergers, however motivated, or by enhanced regulations and supervisory monitoring. While we have no notion of what the minimum effective size for a commercial bank operating in the Caribbean ought to be, we are certain that size is important if a financial institution is to withstand economic shocks, and also for cost efficiency. These can be achieved through mergers.

Rickets (1994) contends that during the 1980s in the United Kingdom and the United States of America conditions favoured a high level of corporate restructuring via takeovers, divestments, and management buyouts. As a proportion of GDP, expenditure on acquisitions was 1% or less in the mid-1950s and mid-1970s. However, in the years 1968, 1972 and 1988 the proportion rose to around 5% or more of GDP. It reached 5% of GDP in the United States of America in 1988. In contrast, Rickets reported that acquisitions in Japan remained below 1% of GDP in 1988, with France and Germany experiencing similar rates. It is largely owing to this reality that our focus in terms of international historical events is biased towards the mergers and acquisitions activity occurring in the United States of America, or studies conducted by researchers in that environment.

During the late 1980s a phenomenon which came to be known as *merger-mania* was facilitated by corporate raiders, investment

bankers and the introduction of what is commonly called junk bonds. In the 1990s the term *mega-merger* is being used, since very large transactions have characterised the kind of mergers occurring. The nineties version has also tended to be a lot friendlier, as hostile takeovers have given way to strategic alliances, financed by stocks and cash.

Whitford (1997) posits that companies are merging like never before because they have no choice. He claims that the risks are strategic, not financial, and that they appear to be worth taking. One of the ways through which corporations expand and grow is through mergers and acquisitions. It is an alternative to growth by internal means or through capital investment. Mergers and acquisitions have tended to follow certain historical patterns, so called *Waves*, with periods either of intense activity or relative inactivity. Evidence from the United Kingdom and the United States is revealing.

Throughout this paper the terms 'merger', 'acquisition' and 'takeover' will be used interchangeably as if they meant the same thing. In the strict academic usage, however, these terms have specific meanings. Below we shall describe each term for the sake of completeness.

A *merger* occurs when two or more companies amalgamate into one entity in order to use their combined resources to achieve common objectives. Usually, the entity continues to exist under the name and control of one of the companies. Sometimes, however, a newly created legal entity is formed, which represents the merged companies; this is commonly called a consolidation. Mergers may be horizontal, that is, between competitors in the same industry; vertical, involving companies in a customer-supplies relationship; or conglomerate, involving companies in diverse industries. In this study we shall be examining mainly horizontal mergers since we are focusing on the financial sector, in particular, banking. Often, in mergers, the shareholders of the combining firms continue as joint owners of the merged entity.

An *acquisition* is generally considered to be a part of the "normal" process of growth of a company, but it may also be a means of

rationalising the structure of declining industries. It represents more of an arm's length deal, with the shares of the target firm being acquired in an act of mutual exchange and the owners of the acquired firm accepting cash, securities or some combination of both, in return for their shares. While in a merger one or both of the firms may cease to exist, in an acquisition the acquired firm becomes a subsidiary of the acquirer.

A *takeover* can often be initiated by an acquisition. A company may initially acquire a minority share in another before making a move to gain control. After purchasing a significant percentage of the shares of a target company, an offer may be made to acquire some or all of that company's stock in order to gain control. The offer is usually attractive to shareholders who gain by selling their shares at a premium. It generally implies that the acquirer is larger than the target firm, though the term 'reverse takeover' is used to describe an acquisition of a large company by a smaller one.

A *tender offer* is the instrument through which takeovers are pursued. It is an offer to shareholders of a target company requesting tenders of shares for purchase by the bidder. Traditionally, in the United States of America, cash was offered; however, more recently other forms of securities are being used. In fact, it has been suggested that the latter have facilitated the *merger-mania*. In the Caribbean context, however, cash seems still to be the preferred instrument.

Tender offers may be partial (seeking less than 100% control of the target), but unlike mergers or acquisitions, which are supposedly friendly, they do not require the approval of the acquiree's Board of Directors. Since contact is made with the ultimate owners of the firm, a tender offer is, therefore, a means by which to accomplish a hostile takeover. A takeover occurs when a company acquires control (usually 51% or more) of the equity shares of another entity. Once completed, the management of the target company runs the risk of losing control, or even their jobs!

The three countries in which the case studies have been conducted all underwent International Monetary Fund/World Bank structural adjustment programmes. Consequently, as part of the conditionalities imposed, these countries liberalised their financial systems in keeping with the market economy approach. New financial legislation was passed and this allowed financial institutions opportunities to enter business areas from which they were previously excluded. Even regional boundaries are now being removed, allowing for cross-border transactions. In the 1990s, in particular, we have begun to witness mergers and acquisitions in the Caribbean, though not of the size and scale as those occurring in the developed countries.

It is in view of the impact that these activities are having on our financial sector that we have undertaken to conduct such a study to determine whether those transactions have been in the public interest and what issues and lessons there might be for policy makers, as they seek to influence the formulation and implementation of public policy, especially in the financial sector. Since 1980, over 130 countries have experienced significant banking sector problems, with 41 crises in 36 countries. Systematic failure has been recorded in Norway, Sweden and Finland. In the Caribbean, Jamaica has been close to systematic failure and other countries have also experienced problems.

The reader will observe that we have not provided in-depth material or analysis of the non-bank financial institutions, but this has been deliberate since we believe that each of the sub-sectors is deserving of a separate study. Our treatment of those areas has therefore been superficial. Our main focus in this study is the commercial banks. We have had to rely extensively on newspaper reports to complete country sections. This was not our preferred approach. However, in an environment where there is unnecessary secrecy about bank information or where the information flow is far from desirable, there was little alternative. In terms of the usual tests for successful acquisitions we could not perform these because of data limitations. The ideal situation for such tests to be conducted is when holding companies acquire other financial institutions and transpose their management on to those companies. This occurred with the

cross-border acquisitions, but owing to data limitations and the recency of those transactions, no attempt was made to undertake any analysis of their success. We hope that in the future such tasks would be undertaken.

Methodology

We have chosen to pursue a "case study" approach in an attempt to understand and analyse the merger activity occurring in the Caribbean. Because of the varying levels of financial sector development in each country, a single analytical approach could not be used throughout the study. However, there is common ground. Interviews were conducted in the three jurisdictions with both former and current executive management of financial institutions involved in merger activity. Because of this, much of the study relies on anecdotal evidence. While we acknowledge the limitations that this imposes on the robustness of our findings, this shortcoming could not be circumvented, especially for Guyana, where there is no formal stock exchange, and also because of the absence of any stock market data to analyse.[1] The stock prices which we present were either reported in the press or provided by the institutions themselves. As for accounting data from Guyana, the financial institutions which presented the best example of merger had not produced formal financial reports for several years. We therefore had to rely heavily on events reported in the press and discussions with persons knowledgeable about the events. In all countries concerned, interviews were also conducted with governmental agencies, where these had involvement in merger transactions.

In the case of Jamaica and Trinidad and Tobago we were fortunate in that both countries had functioning stock exchanges and accounting data were more accessible. Hence, our treatment of the issues in the countries are more thorough and detailed. Data

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1 A call exchange was established in 1994 but very little activity is evident. In fact its current operation is probably under serious consideration because of limited use.

on stock prices were received from the official stock exchange reports and accounting data from the Annual Reports of the commercial banks. Essentially, the approach we take will attempt to determine the effect on efficiency and profitability of banks after the merger, as well as make a comparison with industry rivals by using accounting data.

The reader should note that in most Caribbean countries, for a long time, there were no standards that were consistently observed in disclosure of financial information. Similarly, the legislation on and publication of data relating to the supervision of financial institutions are relatively ill-developed. It is largely because of these shortcomings that we have had to forego a strictly financial analysis approach in favour of one that relies heavily on anecdotal evidence. However, in spite of these limitations, we shall attempt to provide some partial analysis based on available accounting data.

This study is organised into six sections. First, we treat with the historical background of merger activity in general, including theoretical issues. We then pursue a discussion on financial sector mergers in particular, and this is followed by a review of some empirical evidence on the benefits of mergers. Next, we provide some background information on the Caribbean financial landscape before introducing the country studies on Guyana, Jamaica and Trinidad and Tobago. Each country is dealt with in a separate section but because of greater access to information and the author's familiarity with local events, Trinidad and Tobago receives the widest coverage. It is true also that that country's institutions have been most active in acquisitions. We end with concluding thoughts and suggestions. We believe that this document, though intended to guide policy makers, will be of general interest to academic researchers and provide useful information to undergraduate students at University. It should be a valuable reference text for financial institutions.

Chapter 1

Why Companies Merge?

Historical Background of Mergers

Because of the important role played by mergers in the establishment of large corporations in the United States our discussion will focus mainly on events in that economy.

It is generally accepted that the large modern business corporation is the dominant non-governmental institution in most developed societies. This form of organisation is also gaining prominence in developing economies. But this has not always been the case. At one time in the United States of America there were legal limitations on corporations. However, the pressures of rapid expansion in industrial technology helped to bring about changes in the laws, and by 1875 most of the limitations were removed, allowing corporations to become larger and, in many cases, to eliminate competition and achieve monopoly power.

By 1890 legislation was being passed to halt the widespread predatory practices of firms since many important industries in the United States of America had fallen under the control of a single company (Dow, 1965). He referred to that time as the "Age of Economic Individualism," distinguished by owner-managers of the calibre of Carnegie, Ford and Rockefeller. After 1890 the form of the corporate organisation began to change; owner-managers were being replaced by professional managers whose ownership interest was small. The role that shareholders played in running the business became insignificant, leading to the phrase "the bureaucratisation of private enterprise."

Many writers have contended that there have been three merger waves up to the 1980s (Sawyer, 1981; Shepherd, 1990; Scherer and Ross, 1990). The early U.S. mergers occurred in heavy industry in the 1870s. Standard Oil was one of the first companies to undertake such activity when it attempted to achieve market dominance by combining twenty-five petroleum refiners. By the turn of the century it had captured a 90% share of the U.S. petroleum refining capacity. Also, during the 1880s more than two hundred formerly independent iron and steel producers were consolidated into twenty much larger rival entities. And in 1901 the US Steel Corporation was formed by the combination of an estimated 785 plants (Scherer and Ross, 1990).

By the 1890s large scale financiers such as JP Morgan were involved in restructuring scores of industries via horizontal mergers. Manufacturers formed consolidations to escape the severe price competition that developed during the depression of the 1890s. The overwhelming majority of mergers were horizontal rather than vertical, suggesting that market control was the important motive. The number of mergers probably increased owing to the innovations in financing and the availability of skilled merchant bankers and the techniques used to finance and promote consolidations. The aforementioned may have facilitated mergers but it did not cause them. In fact, ruinous competition in the capital intensive industries left companies with but one choice: bankruptcy or combination. Economic distress was therefore the root cause of mergers in the last quarter of the 19th century (Lamoreaux, 1985).

It is generally believed that certain structural changes in the US economy made possible the first merger peak: the creation of a national railway network and the completion of national telegraphic and telephonic communications, which reduced the costs and increased the speed of transportation and communication. There is general agreement that the first merger wave of activity began with the worldwide economic recovery of 1883 and ended with the recession of 1904 (Scherer and Ross, 1990). This wave produced near-monopolies in a variety of businesses but was slowed down by antitrust activities

and a slump in the stock market. The 1890 Sherman Act, enacted specifically to put a brake on the activities which were thought to be anti-competitive, gave rise to much public discontent. It was, however, inadequate in preventing monopolies and mergers, especially those in the form of stock acquisitions for gaining control. Merger activity declined between 1903-1904, perhaps because of a severe recession and the emergence of legal precedents that could prohibit undesirable mergers (Scherer and Ross, 1990).

The second merger wave took place between World War I and the onset of the Great Depression (Ellwood, 1994). It, too, was facilitated by structural changes in transportation and communication, and a booming stock market. Because the extant antitrust laws appeared to discourage mergers creating a single dominant firm, the second wave of activity was characterised by the merger of secondary firms and resulted in the creation of oligopoly rather than monopoly power. It also involved a greater percentage of mergers aimed at vertical integration and diversification. During this wave an estimated 12,000 firms disappeared through mergers.[2]

The third wave began after World War II and reached its peak during the late 1960s. This era was dominated by conglomerate mergers. In some cases, these involved the joining of non-competing products with marketing or production processes and, in other cases, the creation of a portfolio of almost totally unrelated companies under a conglomerate structure (Ellwood, 1994). In 1950, the US antitrust laws were amended to include much tougher restraints against horizontal and vertical mergers, in response to a perceived resurgence of merger activity. What this ushered in was a period of diversification.

The third wave was, however, triggered by a buoyant stock market as well as additional structural changes, the most influential perhaps being the revolution in management science, the post war research and development explosion, and the rise of

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2 Ellwood, (1994) pp. 31-33.

the service economy (Scherer and Ross, 1990). During the 1960s there was a stock market boom and a consequential increase in acquisition activity. It was facilitated by financial innovations which meant that cash transactions were no longer the sole option for financing mergers. These developments, Scherer and Ross claim, created opportunity for profit through mergers that removed assets from the inefficient control of old-fashioned managers and placed them under persons trained in management science. The revolution in management science made possible the reductions in financial and managerial costs and risks that are associated with the acquisition of firms in diverse industries. The 1960s activity, like its predecessors, ground to a halt with a decline in stock prices.

In the 1980s there was another upsurge in merger activity. Though it has not been referred to anywhere as such, for convenience and consistency, we call it the fourth wave. The previous three waves had two things in common: each occurred during a stock market boom and each was facilitated by structural changes in the economy. In our so-called fourth wave, the heightened merger activity coincided with a stock market slump, not a boom. Stock prices were low relative to the replacement cost of capital, making expansion by acquisition less expensive than building new plants. In those circumstances many firms engaged in bargain-seeking merger activity. Merger activity continued during a stock market boom in 1983 and intensified uncharacteristically when prices declined in 1987. However, the bargain hunting that resumed was led by foreign acquirers who found the low stock prices and the weak dollar an irresistible combination(Scherer and Ross, 1990). Also, during the 1980s hostile takeovers, although only a small percentage of all transactions, came to symbolise that period. Previous targets for such takeovers were usually small. However, in the 1980s the new innovative financial instruments such as junk bonds permitted small groups to make takeover bids for multi-billion dollar targets. They were facilitated in their activities by merchant banks and investment houses.

Perhaps it can be said that the merger fervour that started in the late 1980s, which was being referred to as *merger-mania*, has

exceeded all expectations, to the point where by the late 1990s these mergers were being referred to as *mega-mergers*. The 1990s have seen the biggest mergers to date in varied industries: transportation, oil, even the financial services industry, and they are a lot friendlier than those of the 1980s. Hostile takeovers have given way to strategic alliances, financed by cash and stocks. In size, scope and ambition, the mergers of the nineties dwarf anything that came before (Whitford, 1997).

During the 1970s there were on average 33 transactions per year involving more than US$100 million in assets. Since 1980 and up to 1987, the equivalent number of transactions is 192. Ellwood (1994) reports that up to 1987, of the largest 100 transactions occurring in US history, 93 occurred in the 1980s. They involved some of the country's largest firms: Gulf Oil, RCA, Getty Oil, Southern Pacific, to name a few, and represented a dramatic contrast to the 1960s when small firms were absorbed by conglomerates. In 1969, the average merger transaction (in nominal dollars) amounted to US$10.3 million, in 1979 the figure rose to $41.6 million and by 1987 it reached $168.4 million. The year 1998 has been described as the biggest year for mergers and acquisitions; they surpassed US$ 2.4 trillion, 50% above the 1997 total, with American companies making two-thirds of the deals, while one third of them were cross-border.[3] The following provides an indication of the size of mergers and the variety of industries in which they have occurred: Daimler-Benz, a German firm, joined Chrysler in the largest takeover of an American firm, valued at $40.5 billion; Exxon and Mobil announced in December 1998 that they would create the world's biggest company in revenue terms - the merged company would be valued at $86.4 billion; Citicorp joined Travelers in the largest ever financial services merger valued at US$72.6 billion and Bank America and Nations Bank merged to form the second largest US bank with assets of $61.6 billion. All of these transactions and more occurred in 1998. In August 1999, three of Japan's biggest banks, Dai-Ichi Kangyo Bank, Fuji Bank, and IBJ announced

3 Reported in the *Economist*, January 2, 1999, p. 5.

they would integrate their operations by spring 2002. That alliance would produce the world's first US$ one trillion financial group (Trinidad Express August 23, 1999 p. 41). We have not seen the last of them!

International Policy Towards Mergers

What we propose to do here is to outline broadly the policy of governments towards mergers in countries where such activities have been important in shaping the structure of those economies. The US is the country which probably has the longest tradition of regulation specifically designed to control merger activity. Surprisingly, however, there appears to be no evidence, on the part of government, to promote such activity; rather its actions have always sought to prevent firms from attaining market power presumably out of the belief that such power can be used to raise prices to consumers above competitive levels, thereby affecting a transfer of wealth from consumers to firms. In essence then, government policy in the United States of America was geared to ensuring competition among firms. Any acquisition that could substantially lessen competition or create a monopoly was prohibited, and enforced by the Federal Department of Justice (DOJ) and the Federal Trade Commission (FTC).

The post World War II period in Europe witnessed merger waves of impressive proportions. Schmalensee and Willig (1989) contend that in the absence of significant anti-merger laws, horizontal mergers were dominant and helped to transform the corporate economy of Europe in the 1960s. They further suggest that with the exception of petroleum, the largest European firms are of comparable size to the largest in the United States.

In the 1960s most of the European mergers took place within single industries. In sharp contrast to the US, the governments of European countries encouraged concentration by firms. Very few of the new giants were conglomerates (Siekman, 1972). Samuels (1972) contends that the fact that mergers occur and have become almost commonplace is largely the result of government legislation since governments have the ability to restrict such occurrences. He further suggests that in Britain in

the 1960s the Labour Government appeared to be encouraging merger activity as a device for reorganising the industrial structure out of the belief that the majority of mergers had a neutral or beneficial effect.

During the period 1965 to 1973, the Government of the United Kingdom encouraged consolidation by firms in order to enhance their international competitiveness. The aim was to build up "National Champions" (Sudarsanam, 1995). In 1966, the Labour Government created an Industrial Reorganisation Corporation (IRC) to encourage and finance mergers that might help to build enterprises better able to compete in international markets. The IRC acted as a broker in the merger of British Motor Holdings and Leyland and aided in the formation of Europe's third largest electrical equipment manufacturer through the merger of English Electric and Elliot Automation.[4]

The United Kingdom was the first European nation to adopt merger control laws as part of its competition policy. In 1965, the Monopolies and Merger Commission (MMC) was given responsibility for reviewing mergers involving a market share of 33%, later changed to 25%, to ensure that such activity was not against public interest. The Conservative Government was less attracted to mergers as a means of forming enterprises since such activity during the 1965 to 1973 period, did not result in significant benefits. As a consequence, between 1974 and 1983 the policy of encouraging mergers was somewhat reserved and mergers were vigorously scrutinised and some disallowed (Sudarsanam, 1995).

France, like the United Kingdom, actively encouraged large-scale mergers during the 1960s out of the belief that greater economies of scale would improve international competitiveness. In the case of Germany, Charkham (1994) contends that the Germans have never fully accepted the idea that their economy would work best if unrestricted competition is studiously enforced. There is,

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4 See Sudarsanam (1995) p. 195 for wider discussion of the British experience.

therefore, cooperation between companies even though they may be competitors. The Cartel Office scrutinises mergers to ensure that their occurrence would not weaken competition and thereby allow one company to dominate the market. Since 1990, mergers occurring in Europe are subject to European Union regulation. Mergers which have consequences for the whole of Europe are examined by the European Commission. In Europe, the essential concern about mergers appears to be whether they would limit competition and thereby affect the consumer negatively by creating or reinforcing a dominant market position. The essential purpose of the regulations is to promote consumer welfare.

In the case of Japan, mergers among Japanese firms were promoted on a large scale because of the fear of foreign competition (Martin, 1994). Government-sanctioned mergers have played a vital role in the creation of Japan's industrial structure. Many of the largest corporations were formed through mergers. The tendency has been to combine weaker firms with stronger ones (Kester, 1991). Examples of the above strategy are the merger of Price Motors and Nissan Motor Corporation in 1966, and Fuji Iron and Steel with Yawata Iron and Steel to form Nippon Steel in 1970. Large scale mergers are relatively uncommon in Japan but when they occur, they are usually friendly and among companies with established relationships, and are motivated primarily by strategic considerations. Unlike the United States of America, banks in Japan have significant share ownership of major corporations and have actually sponsored mergers, their intent being to alter the structure and performance of industries, to reduce excess capacity, to avoid potentially destructive price competition and to build strong domestic firms capable of competing with major foreign competitors in their home markets (Kester, 1991).

The Japanese, because of their close trading links to the United States of America, may have patterned their antitrust laws after the US laws. The portions of the Japanese competition law that apply to mergers are similar to the US antitrust laws. The concern for market power or dominance is also emphasised, and mergers are prohibited if they substantially restrain competition (Martin, 1994). As we have indicated, however, not many

mergers occur. Kester suggests that the culture of the Japanese is such that the concept of family extends to business in such a way that to acquire another business is equivalent to "flesh peddling."[5]

When we compare international merger policy with what obtains in the Caribbean, we observe that our Governments have not pursued any specific policy towards merger. Their activities in this area have largely been in reaction to public crises.

Theoretical Issues

Two major competing theories of the firm have evolved in the academic literature, and empirical evidence supporting both have been advanced (Firth, 1980):

(i) the neo-classical Profit Maximisation Theory of the firm developed by economists such as David Richardo, J.S. Mill and Alfred Marshall; and

(ii) the Maximising Management Utility Theory advanced by Baumol, 1959 and Marris, 1964.[6]

The neo-classical theory of the firm begins with the general proposition that one firm will bid for another if the value which the potential acquirer places on the target is greater than the value placed on it by its current owners (Sawyer, 1981). A prospective acquirer would likely place greater value on a firm than its current owners if he believed that profits could be increased by raising efficiency. This theory posits that market

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5 See Kester, 1991 and Charkham, 1994 for detailed discussion of the Japanese attitude to mergers. The Japanese word for takeover, Nottori, is also used to describe hijacking and baishu meaning bribery, reflects and reinforces the negative images of mergers and acquisition activity.

6 For a detailed discussion of the theory advanced by Baumol and Marris see Archibald, 1973.

forces motivate firms to maximise shareholders' wealth. It suggests that firms engage in takeovers if these takeovers result in increased shareholder wealth for the acquiring company; such wealth, it is argued, results if the acquiring firm's profitability increases following the takeover.

The proposition of neo-classical theory is that firms merge because of synergy, out of the belief that the sum of the whole is greater than the sum of the parts. In essence, the belief is that the post- acquisition firm is able to operate more profitably than the two independent pre-acquisition firms. It is suggested that the two most important sources of synergy may be derived from increased market power, and the reduction in costs arising from rationalisation of surplus capacity, leading to lower unit costs (Sawyer, 1981). However, the major emphasis of this approach is the difference in value placed on a firm owing to different evaluation of the expected future profitability. Acquisitions are seen as a route through which efficiency and profitability are raised, as firms are acquired by new owners who believe that they can raise profitability. Value maximisation theory suggests that the value of a firm can be increased by replacing inefficient management with more efficient management (Stewart et al, 1984). The acquisition process thus proves mutually beneficial for both firms. On the one hand, the owners of the acquired firm benefit by realising a higher value for their shares than previously existed, while on the other hand, the acquirers gain by the purchase of assets at a price lower than that which they place on it.

During the 1940s and 1950s Clarence Walton and J.K Galbraith, among others, developed a new view of the American enterprise which Jacoby (1973) referred to as the "Managerial Model." This approach emphasised the role of the professional managers, who hold the reins of power without necessarily holding equity, sharing profits or carrying risks, except the risk of losing their jobs. This theory is also known as the Maximising Management Utility Theory (Baumol, 1959, and Marris, 1964) holds that beyond achieving a certain 'satisfactory' level of profits, managers will attempt to maximise their own self- interests, and that these do not necessarily correspond to maximising shareholder wealth.

It is suggested that managers are effectively free from the control of either the unorganised stockholders or the Boards of Directors, whose composition they control through the proxy machinery. It posits that the corporation is no longer operated to optimise profits for stockholders; rather its goal is to maximise the satisfactions of its managers. Firth (1980) contends that management self-interests are likely to include such factors as reducing the risk of losing their jobs, increasing their salary levels, and increasing their power, job satisfaction and prestige. Managerial self-interests can be aided by growth in firm size, and takeovers are the quickest way to achieve this. Marris (1964) argues that managerial capitalism is the name of the economic system of North America and Western Europe where the role of the entrepreneur has been taken over by transcendent management in the modern corporation.

Apart from the two major theories discussed above, another theory which holds wide currency and has similarities with the neo-classical approach is the Market Power Theory (Aaaronovitch and Sawyer, and George and Siberston).[7] This theory places the seeking of market power and strengthening of position of the firm as the key motive behind mergers. The authors make little distinction between mergers and acquisitions and view most acquisitions as being agreed to by both parties and intended to strengthen the joint position of the firms involved. They stress the increased market power as an important source of increased profits.

The approach also stresses that adverse changes in economic circumstances trigger searches for market power, through mergers, as a way to overcome adversity. It is suggested that an adverse change which causes a fall in demand and therefore firms with excess capacity, leaves the industry with the prospect either of price cutting competition, with declining profits, or bankruptcy for some firms. Mergers, it is argued, can be a way of eliminating excess capacity and of saving firms from bankruptcy.

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7 Discussion by these authors is referred to in Sayer (1981).

The emphasis of this approach is on market power, not product efficiency, as a source of increased profits, hence acquisitions do not play a role in disciplining inefficient firms (Sawyer, 1981).

Financial Sector Mergers

Hitherto our focus has been on the study of mergers in general. Since there is no independent theory of the banking or financial firm, we have approached the subject in broad historical and theoretical terms. Our intention, however, is to explore the merger and acquisition activity occurring in the financial sector, hence we devote our attention to events and studies occurring in that sector, except in cases where reference to other sectors is unavoidable. As before, the reader will observe a bias to studies completed in the US economy. This, as we stated earlier, is because of the prominent role played by mergers in the that country.

Most analysts would probably agree with Nanni's assertion that the financial sector, especially banking, is critical to the fulfilment of a country's economic goals, and that its soundness and the maintenance of a competitive environment are essential to achieving that goal.[8] Yet in spite of the importance of commercial banking as a major financial intermediary and as an important link in the monetary transmission process, there is little consensus as to what constitutes a workable and productive theory of the financial firm.[9]

Hancock (1991) suggests that the neo-classical model of the firm has been supplanted by portfolio theory in analysing the behaviour of financial institutions. She finds difficulty with the latter theory which treats banks not as firms, but as rational investors in an environment characterised by risk or uncertainty. In addition, it omits production and costs constraints under

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8 See Nanni, A.V. (1998) in *Bank Mergers and Acquisitions* ed. by Amihud and Miller (1998).

9 Hancock (1991) quoting Klien.

which firms operate, and the portfolio theory literature shows relative neglect of the liability side of the balance sheet.

Spellman (1982) presents an interesting argument. He contends that there is a simultaneous relationship between competition and profits whether in banking or any other industry. He posits that the adjustment process which operates to rationalise any industry can lead to mergers. For him, the financial firm is similar to the production firm. It purchases raw materials (deposits) and employs factors of production (labour and capital) to transform them into earning assets (usually loans and other services). Like in the production firm, profits depend on the efficiency of production and the competitiveness of both input and output markets. However, the financial firm faces a unique problem which imposes a cost on it that is not borne by production firms. The problem results from the contractual claim of depositors, especially in the case of demand deposits, where customers can demand the return of funds without notice.[10]

Since there is no separate theory of the banking firm, Reid (1968) argues that many large banking institutions operate similar to firms in oligopolistic industries: the profit maximisation principle is replaced by a "satisfying" or "utility maximisation" concept. It was Augustin Cournot who in 1838 provided the first exposition of that theory which, according to Shepherd (1980), continues to baffle and to fascinate economists. It involves interdependence among several firms; members of the group can either coordinate or adopt intensely competitive behaviour. A central tendency in ologopolistic markets is for firms to converge on identical prices and product features. Banking appears to fit nicely in the latter category.

There is probably widespread agreement that prices and output decisions are easily derived for firms operating under conditions of pure competition or pure monopoly, that is, assuming that

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10 See Spellman, Lewis J. *The Depository firm and Industry - Theory, History and Regulation,* 1982 for further details.

they hold definite, though probabilistic, expectations about future demand and cost conditions and that managers seek to maximise expected profits (Scherer and Ross, 1990). In the case of oligopoly, the firms are interdependent and acutely aware of it. Each firm, therefore, would be reluctant to take measures that, when countered, would leave all members of the industry worse off. Banks, for instance, usually arrive at decisions based upon the assumptions they make about decisions and reactions of rivals. What this tends to result in is the setting of prices at the monopoly level. It was Adam Smith who remarked:

> People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public or in some contrivance to raise prices.[11]

In the case of firms operating under conditions of oligopoly, Reid (1968) suggests that the firm is not run primarily for the stockholder, but for the enterprise itself. He claims that the aim of the firm is not immediate or even future profit maximisation, but healthy future existence to which the size of profits is an important but secondary consideration. This is not to suggest that bank managers are not interested in profits but it appears that non-economic goals influence their value judgements and decisions as well. While managers seem generally concerned about size of assets, the level of deposits and the value of loans outstanding, stockholders are very interested in the growth of the market value of their holdings and hence in the growth of earnings per share. The latter improves with increasing profitability.

Since the interests of management appear not to be identical to those of the true owners, the stockholders, there is the implication that corporate resources are not used entirely in the pursuit of shareholder profit. It is posited that management dwells on the consumption of amenities at the expense of owner profits (Demsetz and Lehn, 1985). Because of the diffuseness of

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11 Quotation taken from Scherer and Ross, 1990

ownership structure, it is believed that shareholders are powerless to constrain professional management.

In the context of the modern corporation, the separation of ownership and control leads to an important agency problem.[12] Fama and Jensen (1983) contend that the unrestricted alienability of the residual claims of open corporations gives rise to an external monitoring device unique to these organisations - a stock market, where stocks are traded freely. The market for takeovers is another form of external monitoring. Because of the agency problem, takeovers serve not only as a monitoring device but also as an incentive device for management to perform in the stockholders' interest. Varian (1988) contends that if current managers fail to maximise value, a takeover offers a mechanism whereby shareholders can replace the current managers with managers who offer better performance. Further, he suggests that to the extent that acquisitions encourage efficient operations by management, they can be an effective mechanism for enhancing economic performance. Varian's view about takeovers receives support from Shleifer and Vishny who argue that in the light of lack-lustre performance of other disciplinary devices, hostile takeovers are probably the most effective way for shareholders to get rid of non-value-maximising management without bribing them.[13]

What Stigler observed fifty years ago is still very true today, though perhaps on a much larger scale. Writing in 1950, he suggested that the growth of individual firms to great size through merger with rivals is an outstanding development of

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12 Berle and Means' work is most cited on this issue but for recent analysis see for example, E.F. Fama and M.C. Jensen, "Agency Problems and Residual Claims" or, Separation of Ownership and Control", by the same authors, *Journal of Law and Economics* Vol. XXVI (June, 1983). Pg. 301-315 and 327-349, respectively.

13 See Andrei Shleifer and R.W. Vishny, "Value maximisation and the Acquisition Process". *Journal of Economic Perspectives*, Vol 2 No. 1, 1988 pp. 7-20.

modern economic history.[14] Mergers by banks and bank holding companies out-numbered consolidations in every other industry, in each year between 1981 and 1989 (Chamberlain, 1998). She believes that the surge in merger and acquisition activity, in the 1980s, was due to relaxation of merger laws, changes in federal regulations and changes in antitrust policies. Bank holding companies have become the dominant form of bank ownership over the last twenty years. At the end of 1993, 5,464 such companies controlled banks that held 93% of total deposits of commercial banks in the US (Spong, 1994).[15] The 1980s witnessed considerable consolidation in the US banking industry. Between 1980 and 1990, there was a 23% reduction in the number of banking institutions which declined from 12,930 to 9,982. Bank failures and deregulation, which permitted out-of-state expansion, were among the contributory factors (Gunther, 1996). Between June 1993 and 1996, 1645 US banks were acquired and merged (Moore, 1996). Moore contends that the probability of being acquired tends to be higher for banks with low profitability, slow asset growth, low market share and low capital-to-asset ratios.

He uses the efficiency view of mergers to support his argument that acquisitions tend to eliminate banks with sub-par profitability and create the possibility of improved profitability under new ownership. Further, he suggests, if mergers are focused on banks with relatively weak performance, then they can be viewed as a market mechanism that is helping to strengthen the industry.

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14 See George J. Stigler, "Capitalism and Monopolistic Competition. The Theory of Oligopoly - Monopoly and Oligopoly by Merger." *American Economic Review* No 40, 1950 pp.23-34.

15 A bank holding company provides an alternative to individuals owning bank stocks. Spong (1994) describes such a company as any company, corporation or business entity that owns stocks in a bank or controls the operation of a bank through other means. The holding company structure facilitates acquisition of additional banks or diversification into a range of activities.

It has been suggested that a decline in profitability during the 1980s led to a shrinkage in the banking industry, through consolidations and bank failures (Edwards and Mishkin, 1995). Their study shows that bank failures averaged less than 10 per year between 1960 and 1980, but soared to an average of over 200 per year by the late 1980s. These figures on the US economy are very revealing and reinforce our decision to focus on that country. Coates (1998) estimates that after 15 years of interstate consolidation there are over 12,000 independent banking organistions in the US, compared to 600 each in the United Kingdom and France. He further suggests that the top 10 US banks hold 21% of total banking assets, the smallest among all industrial nations, while the top 10 Canadian banks hold nearly 90% of total banking assets. The statistics seem to throw up two possibilities: first, that further consolidation will continue as smaller banks find it difficult to negotiate the difficult economic environment, and secondly, that some small institutions are able to survive because of niche markets. In any event, we believe that 12,000 banks are far too many, and we suggest that by the turn of the century this figure could be reduced considerably, that is, if the current merger-mania continues. We expect that it will.

Mergers in the 1990s

While it was during the 1980s that the number of financial sector mergers exceeded those of all other industries, in the 1990s the scale of merger activity is unprecedented. In 1997, total merger deals reached a record level of $1.2 trillion but this figure was surpassed in 1998 when deals worth $2.4 trillion were consummated.[16] Financial sector mergers led to the creation of very large banks worldwide. Smith and Walter (1998) suggest that a decade of institutional failure and under-performance in banking and financial services around the world have caused this extensive merger and acquisitions activity. We present a survey of some of the merger activity below.

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16 Reported in the *Economist* January 2, 1999 p.5.

In the United States of America the number of commercial banks remained relatively stable until the mid-1980s when their number began to fall dramatically (Mishkin, 1997). He asserted that the decline in the number of banks occurred through consolidations and failures as the banking industry was hit by hard times in the 1980s and early 1990s. During the period mentioned the traditional role of intermediation in which banks were prominent began to be eroded owing to financial innovations which made alternative and cheaper funds available. Mishkin has suggested that basic consolidation is the result of fundamental economic forces which have increased competition and improved the efficiency of the US financial system and further, that such activity would lead to more very large banks. What has transpired during the mid to late 1990s seems to have confirmed his speculation.

Although mergers by financial institutions have increased in frequency since the 1980s, the deals of the 1990s dwarf any that occurred before. With the removal, in 1994, of laws aimed at restricting interstate branching and the coming into effect of laws allowing bank holding companies to merge their branches in separate states, greater bank consolidation became possible. Nations Bank and BancOne, bank holding companies, were able to expand through mergers and to rival the large money-centred banks. In addition, in the area of retail banking there are growing pressures to control and cut costs. The improvement in information technology and financial innovations have transformed the methods of service delivery as well as increased the availability of financial services providers. These developments have also promoted consolidations as firms attempt to become more competitive through expansion.

A number of important mergers occurred during 1996 and in 1997, Bank of Boston merged with Bay Banks, Nations Bank with Boatmen's Bancshares and First Union with First Fidelity. But perhaps the largest bank mergers in the US were the hostile takeover of First Interstate by Wells Fargo, and the merger of Chemical Bank and Chase Manhattan, making the latter the nation's largest bank at the time. Recent events have altered its position. Across the Atlantic, some European countries were

also experiencing bank mergers. In France, the merger of Banque Indosuez and Crédit Agricole occurred, while in Sweden, Svenska Handelsbanken, the biggest bank purchased Stadskypotek, a mortgage lender. In Japan, Bank of Tokyo and Mitsubishi merged to form probably the largest bank in Japan at that time. In early 1997, Sweden's third and fifth largest banks, Swedbank (Sparbanken Sverige) and Foreningsbanken merged into an entity called Forenings Sparbanken, with combined assets at year end 1996 of US$83 billion, to become that country's second largest bank.[17]

Fairlamb (1999) suggests that the introduction of the Euro seemed to have triggered a surge in mergers by European banks. He contends that commoditisation, globalisation, securitisation, and rapid technological advances have made it essential for banks to expand through acquisitions to gain the requisite size that facilitates increased market share. He believes that additional business can help a bank to maintain a decent return on equity, and that size enables a bank to establish a strong brand, to improve its technology, and enhances yield on marketing.

In 1998, Union Bank of Switzerland made a bold and unexpected move when it joined forces with arch rivals Swiss Bank Corporation to form the continent's largest bank, with market capitalisation in excess of £60 billion. It should be noted, however, that market analysts have suggested that the optimal market capitalisation for an ambitious Euro-zone bank is at least £70 billion.[18] Financial services analysts, on the other hand, predict that six or seven continent-wide financial services groups and three or four retail banks will essentially dominate Europe.[19] Also in 1998, ABN AMBRO, the Dutch bank, acquired Brazil's fourth largest bank, Banco Real. This acquisition raised

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17 See the March 1997 issue of the *Banker* for further details pp. 46-47.

18 See story in *Institutional Investor*, March, 1999 p.54. Currently the average capitalisation for Europe's top ten banks is £35 billion.

19 *Op. Cit.*

objections from other large local banks which felt that the policy of allowing foreign banks to purchase local interest only through privitisation or in the case of distressed banks was overruled. In Brazil, a large number of mid-sized to large banks have been acquired either by foreign banks or by large local commercial banks.[20] Germany's Deutsche Bank was involved in a cross-border merger; it acquired Bankers Trust, America's ninth largest bank for US$10 billion. Fairlamb (1999) suggests that the sale of Bankers Trust was driven by losses incurred owing to the emerging market crisis in Asia. In 1998, a total 170 bank mergers were reported among European banks.

As we stated earlier, 1998 was a record year for mergers and acquisition activity. It appears that the urge to merge is not receding. In March, 1999, the shareholders of Spanish banks, Banco Santander and Banco Central Hispanoamericano approved the merger of the two banks, which will create a US$35 billion organisation. France's Société Générale announced that it would acquire Banque Paribas for £15 billion. In the case of the French banks, only two weeks of intense bargaining were needed to complete the merger agreement.[21] In the report cited below it was suggested that there is greater pressure on European banks to merge in order to acquire the critical mass necessary to face the sharper competition expected from banks as well as other financial institutions. Banks' retail customers are being lured away by insurance companies, which dominate the market for longer term savings, and supermarket chains, many of which now offer attractive chequing and savings accounts.

In the Middle East mergers have been occurring also. In Saudi Arabia, the Saudi American Bank merged with United Saudi Bank, and Gulf International Bank acquired Saudi International Bank. In February 1999, two mergers expected to create the largest banks in both the United Arab Emirates (UAE) and in Lebanon were announced. In the UAE, there is likely to be the

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20 See article in *Latin Finance*, January/February. 1999 p. 35

21 See story in *Institutional Investor* March 1999 p. 54 for full details.

merger of National Bank of Dudai and Emirates Bank International, two of the country's strongest institutions. The UAE is currently serviced by twenty local banks and twenty seven foreign banks. *The Banker* (February, 1999) reports that Capital Intelligence, a Cyprus-based bank rating agency, has been urging mergers particularly among the smaller banks, perhaps out of the belief that smaller banks could experience difficulties given the huge investments required to remain competitive. In Lebanon, Byblos Bank and Banque Libnanaise Pour Le Commere (BLC) announced an agreement to create that country's largest bank with combined shareholders' equity of US$360 million.[22]

We have provided a brief account of the merger activity occurring in areas outside of the United States of America simply to demonstrate that it is now a worldwide phenomenon. However, nowhere is the activity more intense than in the United States. The latest round of mega-mergers has drastically altered the ranking order of the top US banks. Bank of America now leads with total shareholder equity of US$45.9 billion followed by Citigroup with $42.7 billion and Chase Manhattan with $23.8 billion. In terms of total assets and pre-tax profits, however, Citigroup is the leading bank, pushing Bank of America into second place.[23]

The reshuffling of the ranking order arose out of recently concluded deals. Citicorp joined Travelers in the largest financial services merger and a week later Bank of America and Nations Bank merged to form America's second largest bank in terms of asset size. Wells Fargo joined forces with Norwest and BancOne merged with First Chicago NBD in October, 1998. It is interesting to note that even though technically Chemical Bank had taken over Chase Manhattan, Chase's name was retained. The same occurred when Nations Bank Corporation took over Bank

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22 Further details can be found in the *Banker* of February, 1999.

23 For a full account of the ranking of top twenty US banks, see article by Michael Blanden in the *Banker*, March, 1999 p.39.

America: the latter's name survived. Presumably, both Chase and Bank America had stronger brand names, and hence they were retained.

Even though 1998 was a record year for mergers the level of profits for most institutions was less impressive when compared to 1997. Merger-related costs have been substantial and these have affected "bottom lines." In the case of the Wells Fargo/ Norwest deal such costs were reported to be of the order of US$1.2 billion while in the First Chicago NBD and Banc One merger costs of US$984 million were incurred.[24] It is interesting to note that three of the top four US banks recorded significantly lower pre-tax profits in 1998 (on average, 20.0% lower). In spite of this, Blanden (1999) suggests that the trend towards consolidation will continue because the banking environment could become more testing. He claims that competitive pressures are getting stronger, especially for savings deposits among other service providers. Another danger was identified by Keete, Bruyette and Woods, who found that for both small and large banks expense growth was exceeding revenue growth.[25]

Increasing Frequency of Mergers

We believe that thus far we have demonstrated that mergers among financial institutions are fairly common and widespread. But why have they been occurring with such frequency? And what, if any, gains are to be derived from mergers? We now turn to these issues while the following section will review the empirical literature on merger gains.

It may be useful to first distinguish a bank level merger from a bank holding company merger since these are the primary approaches used in describing mergers. A bank level merger

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24 Reported in the March, 1999 issue of the *Banker* p. 39.

25 These analysts have shown that for the top 50 banks, revenue growth of 9% has trailed expense growth of 10%. For the next 40 institutions, the margin was wider, 13% and 15% respectively. See the *Banker*, March 1999 p. 40.

occurs when two separate and distinct entities are joined into one organisation. Many such mergers have occurred throughout the world and these are usually studied to determine their impact on changing organisational structure. In general, no assessment of the gains resulting from new ownership is conducted but it is precisely that which economists view as the centrepiece of analysis of merger and acquisition activity (Pilloff and Santomero, 1998). In the case of a merger at the holding company level, this is distinguished by a change in ownership of a subsidiary bank or group of subsidiary banks, whether or not they are consolidated.

Regarding the increasing frequency of acquisitions Pilloff and Santomero (1998) contend that consolidation in the US banking industry is based on the belief that gains can accrue through expense reduction, increased market power, reduced earnings volatility, and economies of scale and scope. They suggest that the primary cause of gain in mergers is derived from improvements in post-merger performance, usually efficiency improvements, increased market power or heightened diversification. Many mergers are motivated by the belief that a significant quantity of redundant operating costs could be eliminated through the consolidation of activities such as back office functions and other administrative areas, for instance personnel functions. Wells Fargo, for instance, estimated annual costs savings of US$1 billion from its 1996 acquisition of First Interstate. Nations Bank, on the other hand, believed that it could improve its revenue efficiency by cross-selling products of its merger partner Boatmmen's Bancshares. We are not aware of any research which has confirmed these expectations.

An alternative view has been presented by Macey and Miller (1998). They argue that the merger wave in banking is more a display of weakness than a sign of strength among banks in the United States. They claim that changing technology has led to a diminution in the overall demand for banking services, and this has resulted in a surge in merger activity. They conclude, therefore, that banks are merging as a mechanism for downsizing. They suggest that bank mergers should be viewed as a low-cost substitute for bank failures. Since it is the weaker

firms in an industry which are likely to fail, they argue that such firms would most likely be candidates for takeovers because they provide the greatest possibility for arbitrage of profits by superior managements. In their view, mergers are a substitute for insolvency and should be preferred to liquidations and insolvencies because they are more efficient.

Chapter 2

Analysing the Success of Mergers

Testing Merger Gains

Most academic studies follow one of two approaches to estimate and evaluate the significance of merger-related gains: operating performance studies or the abnormal returns methodology. In the case of the former, this approach uses accounting data to compare the pre-merger/post-merger performance in order to determine whether consolidation resulted in changes to costs, revenue or profit figures. It is the standard corporate finance measure to analyse the effect of mergers. In order to conduct this analysis the merged banks are compared, before and after merger, to a controlled group of non-merging banks and the following ratios derived:

(i) non-interest expense to assets - a measure of efficiency;

(ii) net income to assets - return on assets (ROA), and net income to equity-return on equity (ROE) - ratios measuring profitability.

Pilloff and Santomero (1998) believe that the strengths of this approach are that accounting performance can be directly measured and that the data used are both easily obtainable and well understood. They argue that actual performance conditions are measured, not investor expectations. However, they contend that there are several drawbacks with this measure. They claim that since the data are based on historical figures they may

neglect current market values. In addition, the observed changes between periods may not be due solely to the merger. Failure to take into account other events which could influence the performance changes may lead to the wrong conclusion.

The second approach is the "Abnormal Returns" or "Event Studies" methodology. This measure has been widely employed in the finance literature to examine the gains from bank mergers (Boyd and Graham, 1998). It measures shareholder wealth changes by comparing the returns to shareholders of both bidders and targets during a period surrounding the takeover announcement to "normal returns" from a period unaffected by the takeover and hence the usage of the name "Event Studies." It is argued that because market data are relied upon, as opposed to accounting figures, it more accurately measures the implied value of merging two independent firms.[26] The market's reaction is thought to be a better indicator of the real economic effects of the announced merger. Immediately upon the announcement of a bank merger, stock prices are expected to reflect the market's best prediction. Positive abnormal returns signal good predictions. The converse is also true. Such expectations are based on the idea that equity markets are speedy and efficient aggregations of information.

The "Event Studies" approach has also been criticised. Rhoades (1994) believes that two factors seriously undermine the usefulness of event studies. He posits that the financial market's response to stockholders reflects expectations about all of the elements (not only efficiency) that may influence the general performance results of a merger as well as differences in expectations between investors and bidders. He suggests, also, that "Event Studies" are based on short-term movements in stock prices which may reflect speculation by sophisticated investors who seek short-term gains by outguessing other sophisticated market players. It has also been criticized on the timing of the analysis. Boyd and Graham (1998) suggest that results from

26 See Pilloff and Santomero (1998) pp. 59-78 for further discussions.

event studies should be viewed with caution because they depend significantly on technical details such as the length of the "event window."

Rhoades (1994) reviewed thirty-nine studies published over the period 1980 to 1993 on the performance effect of mergers, nineteen of which used the operating performance approach, with the remainder employing the event studies methodology. He concluded that the results of the operating performance studies are generally consistent, with virtually all finding no gain in efficiency, and all no improvement in profitability. Despite substantial diversity, all of the studies point strongly to a lack of improvement in either efficiency or profitability after bank mergers. In contrast, he found some inconsistency with the results of the twenty event studies. Seven found no effect on bidders' returns, three found positive returns and four found mixed results. In view of his findings, Rhodes believes that the problems inherent in the event studies methodology are more troublesome than in the operating performance studies.[27] He therefore concludes that one is justified in giving greater weight to the operating performance studies.

Review of Empirical Literature

In general, the primary motive cited for bank consolidation is cost reduction and hence most empirical works focus on the efficiency gains of mergers. With respect to operating performance studies Pilloff and Santomero (1998) cite studies by Berger and Humphrey, and De Young which produce fairly close results. In the case of the former, the authors examine mergers occurring in the 1980s that involved banking organisations with at least US$1

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27 Support for Rhoades' argument appears in Scherer and Ross (1990) pp 167-174, in section on Statistical Evidence on Merger Outcomes. Berger (1998) has provided a critique of most of the studies appearing in the 1990s.

billion in assets, by frontier methodology,[28] using aggregate holding company data, and the relative industry rankings of banks participating in mergers. They report that on average, there were no gains in X-efficiency. They arrive at similar conclusions after analysing return on assets, and total costs to assets. They conclude that the amount of market overlap and the difference between acquirer and target X-efficiency did not affect post-merger efficiency gains. In the case of De Young, he also utilises frontier methodology to examine cost efficiency and reaches conclusions similar to those of Berger and Humphrey. However, he observed that when both the acquirer and target were poor performers, mergers resulted in improved cost efficiency.

Boyd and Graham (1998) examine the effects of small bank mergers that occurred in 1989, 1990, and 1991 in the US.[29] They tested the efficiency results by comparing performance variables in the year preceding the merger with each of three years following the merger, excluding the merger year itself. Three performance measures were used: the ratio of net income to total assets, the ratio of non-interest expenses to total assets and the ratio of total expenses to total assets. Their findings suggest that there can be efficiency gains to merging, but these depend on the size of the banks involved. They contend that the smaller the banks, the greater the merger benefit. They conclude that except for their work, which points to improved performance when small banks combined, there is little evidence that consolidation in US banking has led to much improvement in performance, perhaps owing to the fact that consolidations have been concentrated in the acquisition of medium-sized to large banks, which present the least potential for gains due to scale economies.

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28 Frontier methodology involves econometrically testing an efficient cost frontier for a cross section of banks. For a given institution, the deviation between its actual costs and the minimum cost point on the frontier corresponding to an institution similar to the bank in question measures X-efficiency.

29 A small bank, as defined by Boyd and Graham, is one with less than $1 billion in assets.

Berger (1998) employs three separate X-efficiency concepts: cost efficiency, standard profit efficiency and alternative profit efficiency to measure whether mergers on average improve the three types of efficiency, and to determine if there is any way to predict which mergers are likely to be successful in improving efficiency. His findings suggest that bank mergers appear to yield statistically significantly increases, of a few percent, in profit efficiency rank, on average, relative to other banks, but very little change in cost efficiency. For banks with low efficiency, the average improvement in efficiency rank is substantial. Similarly, for banks which were relatively efficient *ex ante*, efficiency tended to decline significantly after merger. Berger concluded that large *ex post* efficiency improvements result if either the acquiring bank or acquired bank is less efficient *ex ante*.

It appears that the general consensus of the above studies, which all used the operating performance approach, is that there can be efficiency gains when banks merge. However, this depends on bank size and the relative efficiency of banks, *ex ante*. We may, therefore, conclude that cost efficiency could be enhanced by mergers, in particular when relatively inefficient banks are acquired by relatively efficient banks whose management possess superior qualities and can use these to marshall the combined resources better. We should note, however, that Berger (1998) suggests that the appearance of little or no improvement in cost efficiency from the mergers of the 1980s could probably be explained by managerial difficulties in monitoring large organisations.

We now review some studies which employed the "Abnormal Returns" methodology. Firth (1980), in analysing the impact of takeovers on shareholder returns and the benefit to management, found that the acquired firm's shareholders made large gains from takeovers. However, in contrast, the acquiring companies' shareholders suffered losses that slightly more than offset the gains to the acquired firms. Analysis of the impact of takeovers on the remuneration levels of directors found that they benefitted from exceptional increases. He therefore concluded that the evidence was consistent with takeovers being motivated by maximisation of management utility. Malatesta (1983)

examines the net effects of the long-run sequence of events leading to merger, and of the merger itself, on shareholder wealth. The results show a positive impact on acquired firm wealth. However, because acquired firm shareholders apparently suffer wealth losses prior to a merger, the estimated net impact of the events culminating in merger, on the acquired firm shareholder's wealth, is negative.

With respect to the abnormal returns studies, the works of Hannan and Wolken, and Houston and Ryngaert are cited by Pilloff and Santomero (1998). Hannan and Wolken's study of the value-weighted abnormal returns experienced in 43 merger deals announced between 1982 and 1987 found that, on average, total shareholder value was not significantly affected by the announcement of the mergers. Houston and Ryngaert examine abnormal returns from four days before the target was declared a takeover candidate to the announcement day. In their sample of 153 mergers announced between 1985 and 1991, acquirers suffered a loss in value and targets enjoyed a gain. However, they found no significant aggregate effect on the overall value of the two organisations. When acquirers were strong pre-merger performers, and substantial overlap existed, the value created tended to be highest.

The review of the abnormal returns studies also points to very little overall value created by mergers, hence we now review a study by Pilloff (1996), who combined both approaches to analyse a sample of 48 mergers of publicly traded banking organisations occurring between 1982 and 1991. His results are consistent with the bulk of the merger literature. In general, he finds that mergers are not associated with any significant change in performance. Although there was no average change in either operating performance or shareholder value, there was a great deal of variation among banks; some mergers succeeded while others failed.

It appears that most of the studies failed to find any significant gains in either performance or stockholder wealth resulting from mergers, and these conclusions hold across a variety of methodologies and levels of analysis. For more detailed reviews

of empirical literature the reader may consult Pilloff and Santomero (1998), Berger (1998), and Rhoades (1994), among others.

Given what we have just concluded, what then are the factors upon which the assessment of Caribbean merger activity should be based? In the vast majority of regional mergers, concerns about the integrity of the financial system superceded any of the usual economic factors which drive mergers in the industrialised countries. It would, therefore, appear inadequate to assess Caribbean mergers solely on the basis of the foregoing standards. Since the merger occurrences appear to be primarily a response either to failure or shocks to the financial system rather than concerns about efficiency or financial returns, the analysis should attempt, as far as possible, to determine if such activity resulted in the stability of the sector or prevented totally undesirable consequences.

Chapter 3

Evolution of the Caribbean Financial Sector: A Summary

Before discussing merger activity in the Caribbean financial sector we believe that some historical insight into the evolution of this sector is useful. The reader should note, however, that we have chosen not to document the structure of the Caribbean financial structure though we recognise that such information is relevant and important. We did not wish to spend time covering material that has been adequately elaborated upon. Instead, we refer readers interested in such information to Clarke and Danns (1997) where individual country analysis is provided for Caricom countries. Our focus will be on the Anglophone Caribbean, in particular, the countries of Guyana, Jamaica and Trinidad and Tobago.

Following the abolition of slavery it was recognised that the demands of a free labour economy would necessitate the creation of institutions to provide banking services in the British colonies. The British Government had anticipated the need for a bank to finance production and to facilitate commerce, and the Colonial Office, in 1834, issued the Colonial Banking regulations which set the stage for the establishment of banks in the colonies.[30]

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30 See Best and Brown, 1992, for expanded discussion.

Guyana, Trinidad and Tobago, Barbados and Jamaica were the first territories to host commercial banks. The smaller islands began this interaction in the last quarter of the 19th century. The Colonial Bank of Guyana was established in 1836; it preceded those in Trinidad and Tobago and Jamaica which were established in 1837. The primary concern of these institutions lay in the financing of sugar production and the importation of supplies to the colonies. The Colonial Bank was not the first financial intermediary in either Guyana or Jamaica, though it was for Trinidad and Tobago. In 1828, the Savings Bank for slaves was established in Guyana, and in 1836 the Bank of Jamaica was the first commercial bank established by English merchants to cater to the needs of sugar planters.[31] By the turn of the century Canadian banks began arriving in the Caribbean. Initially, their services were allied to the movement of goods, and expatriate government officials.

Except for Guyana, there were no financial institutions which catered to the needs of the recently emancipated people. The former slaves and the indentured immigrants were not served by the banking system. Their meagre savings did not warrant the attention of the banking community (Best and Brown, 1992). In an attempt to facilitate public savings the territorial governments set up Post Office Savings Banks. But these facilitated only half the needs of the people; no credit was available in times of emergency or death. It was in these circumstances that people's organisations such as the Friendly Societies, Building Societies, and later, the Credit Unions, emerged.

Banks were established, therefore, not to service the needs of the general public but the interests of a small group. With the passage of time their outreach was extended, especially in the area of savings mobilisation; but in terms of their credit policies, a large section of the regional population was inadequately serviced. With the demise of the plantation economy, the focus of

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31 This should not be confused with the current Bank of Jamaica; the former was a commercial bank, the latter is that country's Central Bank.

banks turned from financing sugar production to the financing of retail and distribution activities. This situation changed only with the achievement of political independence from Britain, when the newly elected governments began to address what they perceived to be imbalances in the system. One of the early initiatives was the establishment of indigenous commercial banks.

In view of the above developments it is no surprise that commercial banks dominate the financial sector in every Caribbean country. Clarke and Danns (1997) suggest that their dominance takes on a greater significance when it is recognised that most commercial banks own most of the near-banks operating in the environment. The Governments of the various countries are also directly involved in the financial sector through ownership of various banks and financial institutions, and through the management of social security funds. However, the Caribbean financial sector is highly fragmented, with the financial sectors of the different economies operating largely in isolation. Most Caribbean-based financial institutions operate in just a single country, although a number of foreign commercial banks continue to operate branches.

Because of the structure of the financial sector, the cost of capital is extemely high, and available mostly at the shorter end of the funding spectrum, generally with maturities not extending beyond five years (Clarke and Danns, 1997). Consequently, the small and micro-enterprise sectors, which are considered high risks, and where entrepreneurs usually lack collateral, have limited access to investment credit. The response of governments to this situation has been to set up a number of agencies geared specifically to provide credit to those enterprises. In Jamaica, there is the National Development Foundation, in Guyana the Institute of Private Enterprise Development and in Trinidad and Tobago, the Small Business Development Company and the Trinidad and Tobago Development Foundation Limited.

After the attainment of political independence, the newly independent countries set about establishing individual central banks. These were followed by the creation of indigenous

commercial banks and later, initiatives aimed at localisation of the foreign-owned commercial banks. Through these measures it was hoped that credit facilities would become available to the majority of the citizens who were unable to access credit from the foreign-owned banks, because they could not meet the collateral and other requirements. From their inception the indigenous banks were well received by the population, who now enjoyed easier access to credit, but it was soon realised that their operations were not altogether satisfactory. Huge provisions for bad and doubtful debts were not uncommon, and since these institutions were government-owned, this meant a drain on the state resources. It also meant that politicians could influence the lending activities of the banks, not a very desirable situation. In all of the countries, Guyana, Jamaica, and Trinidad and Tobago, the indigenous commercial banks set up by Government ran into difficulties; huge bad debt portfolios characterised all of them.[32] The level of management and supervision of these institutions was poor and relatively ineffective compared to the foreign-controlled banks. This in part explains the merger and acquisitions activity which became necessary to rescue the financial system from collapse, but it is not the whole story.

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32 More details on bad debt portfolios will be presented in sections on individual countries.

Chapter 4

Mergers and Acquisitions: The Guyana Experience

Despite the occurrence of probably the first financial sector merger in the Caribbean, Guyana's financial sector is considered to be the least developed among the larger CARICOM countries, and perhaps in all of CARICOM. This country's experiment with "Cooperative Socialism" in the early 1970s resulted in significant expansion of state ownership of the economy and considerable loss of human resources through emigration. By 1976 state ownership was estimated to be close to 80% of the economy.[33] The opportunities available to private business shrank and the banking sector had fewer lending possibilities open to it. Danns (1992) contends that when the economy began to experience severe internal and external shocks in the mid-1970s, the Government held steadfast to failing policies that swung the economy into severe crisis. It was in such circumstances that a restructuring of the economy, including the financial sector, through government's acquisition of foreign commercial banks, was pursued. But it was earlier, in the first decade of the twentieth century, that the first merger occurred.

Almost three scores and ten years after the establishment of the Colonial Bank, Canadian banks made their entry into Guyana. Trade and commerce between the two countries began to increase and commercial banks saw an avenue for profits by financing such activities. It was in 1904 that the Royal Bank of

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33 Reported in "Crisis, Adjustment and Recovery: The lessons of Recent Experience from the Guyana Economy," Danns (1992).

Canada acquired the assets of the first locally owned private bank, The British Guiana Bank, which had been set up to service the sugar industry.[34]

In Guyana, the merger experience came about largely as a result of government initiative, as the Government sought to divest itself of state enterprises. It was so at the beginning of the 20th century and it remained the same in 1997, when the most recent merger was completed. After the acquisition by the Royal Bank of Canada, the next transaction occurred in 1910, when a court order permitted the amalgamation of the Government Savings Bank (GSB) and the Post Office Savings Bank (POSB) under the name and control of the latter.[35] In between the two extremes there were only sporadic transactions.

After a period of approximately seventy years another financial merger took place and it involved POSB, the institution which survived after the 1910 merger. By 1970, the Government of Guyana had established an indigenous commercial bank, the Guyana National Commercial Bank (GNCB) whose mandate it was to provide critical support to the local sectors which were neglected by the foreign-owned banks. The establishment of this bank was consistent with its ideology and its desire to control the "commanding heights" of the economy. In 1977, POSB and GNCB were merged; at the time POSB was experiencing difficulties. It has been suggested that a loss of public confidence in the institution coupled with the Government's desire to expand the newly created GNCB caused its decline.[36]

Guyana experienced severe economic difficulties between the mid-1970s and the early 1980s. The foreign commercial banks were not being allowed to repatriate profits, because of foreign

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34 See Danns (1986) for additional material on this issue.

35 The Savings Bank for Slaves was later renamed the Government Savings Bank, See Russell and Khan (1998) for more details.

36 Donna Danns (1986) provides a wide-ranging discussion on the demise of savings banks.

exchange shortages, and this contributed to their decision to exit the environment. A statement by the country's Minister of Finance in the 1985 Budget Speech provides ample evidence of the Government's vision for the country.

> "In a situation where foreign exchange is short transnational banks may actually support development by bringing in convertible currency. In the absence of the latter facility a country has the duty to run all of its own banking business thereby saving itself the headache of blocked earnings ..." Carl Greenidge (1985)

An interesting piece of legislation was passed in 1985 which drove a further nail in the coffins of foreign banks. The new legislation required foreign banks to bring in capital to back their operations in Guyana. These actions clearly signalled the Government's intention to assume control over the banking system, since foreign banks were unwilling to bring in new capital when there was no assurance that they would be allowed to repatriate profits.

Both the Royal Bank and Chase Manhattan Bank were acquired by Government in 1985. Royal Bank left behind assets worth G$8 million in exchange for a commitment from the Government to pay G$30 million over ten 10 years or alternatively to have the G$30 million written off as a bad debt. Whatever the option chosen, the Government of Guyana benefitted. The assets were vested in a new entity, the National Bank for Industry and Commerce (NBIC). The assets of Chase Manhattan were acquired for G$1(a symbolic gesture) and vested in another newly created entity, Republic Bank Limited. In 1987, the Government established the Guyana Bank for Trade and Industry (GBTI) consequent to its acquisition of Barclays Bank D.C.O., the assets of which were vested in the new bank. With the completion of this transaction the Government was firmly in control of four commercial banks. Most observers felt that these newly created institutions would not be effectively managed because of political interference. This appears to have been a reasonable conclusion given the prevailing ethos of the then Government's state control of the economy. Table 1 provides a glance at the extant financial institutions between 1975 and 1995.

By the late 1980s there was a reversal of economic strategy, as Guyana had to seek the assistance of the multi-lateral lending agencies. The package of reform measures recommended by these institutions usually includes a reduction of direct government participation in the economy and the encouragement of private enterprise activity. In the 1987 budget speech government signalled its intention to divest selected public enterprises, and by 1989 it effected the merger of Republic Bank Limited (one branch) and GBTI (two branches). This action was seen by many as a precursor to the divestment of the combined entity, since it was believed that persons would be attracted to share ownership in a larger organisation. The decision to merge both institutions was not preceded by any announcement of strategic motives or intent. None was identified. Senior management of the merged institutions felt that the process was not well thought out, simply because a decision to divest had already been made. Since it involved two small banks, no staff was severed by the merger but some persons who previously held senior positions found themselves holding lower positions in the new entity. This probably acted as a demotivating factor and perhaps led to the eventual departure of some staff. In the case of this merger no economic reasons can be identified. It was strictly on government's initiative, presumably to satisfy conditionalities imposed by the multilateral financial institutions.

In 1991, the Government, in following up on its mandate to divest itself from economic activity, sold seventy percent of its shares of GBTI for about G$ 200 million. The Beharry Group of Companies, through its financial investment arm, Secure International Trust Company (SITC), acquired sixteen percent of the shares at that time but increased its shareholding to twenty-three percent by 1992, through purchases by its stockbrokering agency. A new government was elected in 1992 but it continued the divestment initiatives set in train by its predecessors.

Table 1
Guyana:
Number of Financial Institutions

Institution	1975	1980	1985	1990	1995
Central Bank	1	1	1	1	1
Commercial Banks	6	6	6	5	7
No. of Branches (Commercial Banks)	28	18	N.A	N.A	23
Trust Companies	2	N.A.	N.A	N.A.	4
Licensed Forex Dealers	0	0	0	0	29
Insurance Companies	16	N.A.	N.A.	N.A.	11
Development Banks	2	2	2	2	1
Savings Banks	0	0	0	0	0
New Building Societies	1	1	1	1	1
National Insurance Scheme	1	1	1	1	1
Pension Scheme	0	0	0	N.A.	22

Source: Bank of Guyana *Annual Reports*.

In the 1994 Budget Speech the Government announced its commitment to lowering its participation in the financial sector through restructuring and privatisation, and indicated its intention to rationalise the operations of GNCB and the Guyana Cooperative Agricultural and Industrial Development Bank (GAIBANK), and to divest its remaining shareholding of GBTI. Later in 1994, the Government put its remaining shareholding of thirty percent up for sale. It set a minimum price of G$130 (the existing nominal value per share was G$10) and left the offer open for forty-five days. The Government had hoped that affluent nationals, resident abroad, and the local business sector would be attracted but there were only forty-six bids tendered, and half were ruled out because of non-compliance with the terms and conditions of the offer. In addition, the offer price excluded the ordinary citizen whose average daily wage was less than US$2.[37] Twenty two of the bidders subscribed to 8,345 shares, and the Beharry Group won the remaining 5,991,655 shares, paying G$898.7 million and gaining control of 53% of the bank. Prior to the public disclosure of bids on June 15 1994, Beharry Stockbrokers Limited publicly maintained its offer of G$38 per share; however, when the bids were opened, Secure International had made a record offer of G$150.[38] The Government, though subject to strong criticism from various quarters because of its stated position regarding widely subscribed shareholding, seemed completely satisfied with the transaction. The Minister of Trade, Tourism and Industry is reported to have said that "the sale was a great success, in financial terms; we sold to the highest bidder and the nation benefitted."[39] Exactly how the nation benefitted is not clear. One does not know, for instance, whether the acquisition by a private company promoted any improvement in service quality, or whether it increased people's access to banking facilities.

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37 In 1994 the average daily exchange rate of the US dollar per Guyana dollar was US$1=G$142.

38 We have relied heavily on the report of Indranie Deolall in the *Caribbean Week* Magazine, July 22 1994, to complete this section.

39 Reported in *Euromoney*, September, 1994.

Following the acquisition by the Beharry Group there was a volley of public calls for the Government to legislate limits on the concentration of ownership by any one shareholder. This concern was addressed by the Financial Institutions Act, 1995 which was amended to prevent any person or group who owned a commercial bank from gaining control of another bank, by limiting the purchase of shares. This was an important piece of legislation since in 1995 the Government's shareholding of NBIC was placed on the market.

A Privatisation Policy Framework Paper 1994-1996 had been published and issued by the Government in June, 1993. Among the financial institutions earmarked for privatisation/ restructuring were NBIC, GNCB and GAIBANK. Presumably, the Government took note of two separate studies conducted on GNCB. In 1990, the operations of GNCB were reviewed by the Commonwealth Fund for Technical Cooperation, which concluded that its management practices were outdated, and that its loan appraisal technique and procedures led to a huge poor quality portfolio.[40] Also, an accounting firm which had been engaged to review the operations of both GAIBANK and GNCB recommended a merger as a way of strengthening GNCB.

The Guyana National Cooperative Bank founded in 1970 was the first indigenous commercial bank established by the Government. Initially GNCB's mission was to facilitate the flow of investible resources into areas that could bring about a transformation of the national economy. It therefore committed resources to the agricultural sector in order to improve the production and distribution of agricultural products. State enterprises and other governmental agencies were directed to use its services and hence by the early 1980s it was Guyana's largest bank. The establishment of GNCB might have improved the flow of resources to the agricultural sector but agricultural credit was still insufficient. Thus, in 1973, the Government set up the Guyana Agricultural Cooperative Development Bank (AGRIBANK)

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40 See Report of the Commonwealth Advisory Group - *Guyana Economic Recovery Programme and Beyond, 1989.*

to provide credit aimed at promoting the development of small scale agriculture.

In 1978, AGRIBANK took over the operations of the Small Industries Corporation (SIC) and expanded its operations to include agricultural credit. Consequent to its absorption of SIC it became known as the Guyana Cooperative Agricultural and Industrial Development Bank (GAIBANK) with its main responsibility being the provision of credit to projects of a developmental nature. Perhaps because both GNCB and GAIBANK were involved in providing credit to the agricultural sector, a decision was taken by the Government to merge them. An Act of Parliament was passed to facilitate the merger since both entities were state- owned. The merger was effected in 1995.

The decision to merge a commercial bank, GNCB, with a development bank, GAIBANK appears curious. On the one hand we have a government institution receiving funding from international agencies, and specialising in development financing and on the other an institution providing lending resources through customers' deposits. The two institutions are in no way compatible, neither do they complement each other. One expects the commercial bank to be more risk averse than the development bank. But was this the case? Because it was a state bank, administrative pressure was brought to bear on GNCB's operations. People generally believed that party faithfuls could easily access loans. Indeed, there have been suggestions that at GNCB political issues appeared to take paramountcy over serious financial considerations in the granting of loans. Some persons have suggested that because political appointments were made at GNCB, the level of managerial skills might have been lacking and that this probably led to the poor performances.

Table 2 (a)
Guyana: National Cooperative Bank - Efficiency and Profitability Ratios

Year	Return on Assets	Return on Equity	Expenditure to Income Ratio	Non-Interest Expense to Asset	Total Expenses to Asset Ratio
1970	0.55	-	88.0	3.0	4.2
1974	1.24	27.6	78.1	3.9	5.6
1975	0.86	27.7	82.2	3.7	5.4
1976	1.0	35.6	79.1	3.0	4.8
Avg	0.91	29.6	79.3	3.4	5.0

Source :Computed from *Annual Reports* of GNCB

Table 2 (b)
Guyana: Cooperative Agricultural and Industrial Development Bank - Efficiency and Profitability Ratios

Year	Return on Assets	Expenditure to Income Ratio	Total Expenses to Assets Ratio
1979	(0.08)	101.1	7.4
1985	2.3	84.4	12.5
1988	(1.7)	109.6	19.8
1991	9.4	59.0	13.5
Avg	2.4	88.5	13.3

Source :Computed from *Annual Reports* of GAIBANK.

Table 2 (a) reveals that GNCB got off to a relatively decent start, earning profits between 1970 and 1976. It is noticeable, however, that during those years its operations incurred relatively high costs. On average, it spent about eighty cents to earn one dollar. While Table 2(a) does not cover the same period as Table 2 (b) we observe that GAIBANK (GAIBANK established in 1978) showed mixed fortunes over its first ten years of operation. Its operating efficiency, however, appeared to be worse than that of GNCB, with its expenditure to income ratio averaging in the high eighties, with some periods greater than 100%. This may be acceptable for a developmental institution initially, since its primary concern is to provide resources to projects which may not receive commercial bank funding, but after ten years of operation, its indifferent performance should have raised questions about the overall efficiency and viability of the organisation. One expects that with experience aspects of organisational performance should improve, not decline. By 1991, however, the last year for which we have data on GAIBANK, it had shown significant improvement in operating performance, its expenditure to income ratio falling to below 60%, while its profitability ratio evidenced significant improvement. Unfortunately, at December 31 1991, it had recorded a cumulative deficit of G$935 million owing to foreign exchange losses on its long-term liabilities due to devaluation of the Guyana currency. At the end of 1991 GAIBANK had a negative net worth of G$781 million. Even though the institution's performance had begun to show promise, by then it was in reality insolvent. Given that Section 50(2) of the Cooperative Financial Institutions Act Chapter 75:01 of the Laws of Guyana states that all losses must be covered by the State, the Government was compelled to take corrective action.

During the late 1980s and early 1990s Guyana found itself burdened with a huge international debt which forced the Government into negotiations with international agencies for assistance and debt relief. Meanwhile, in 1990 GNCB recorded losses of G$1.0 billion. The Government therefore owned two institutions which were placing heavy demands on it for resources which it did not have. If anything, divestment seemed to be the logical choice but it was not the one made. Instead, the

Government proceeded to divest its holdings of more profitable and well run banks, GBTI and NBIC and continued to inject scarce financial resources to shore up two ailing banks.

In 1990, GNCB held the largest assets among indigenous banks for which data are available. At the time GBTI, with G$2.1 billion in assets, about 50 percent less than GNCB, was considered to be the smallest bank. By 1993, GBTI had caught up with GNCB, each holding assets of over G$10 billion while NBIC held the lead with almost twice the assets of its nearest rivals. In terms of GNCB's share of the market for loans and deposits, these, too, declined drastically. GNCB's market share of deposits declined from 40.9% in 1990 to 23.57% in 1995, while its loan market share declined from 39.5% in 1990 to 16.1% in 1995. GBTI was the institution benefitting most from GNCB's decline, its respective loan and deposit shares increasing from 11.1% to 30.5%, and 13.7% to 22.4% between 1990 and 1995 (See Tables 3a & 3b). It should be noted, however, that Government, in 1993, took a decision to reverse its policy that all state agencies should bank with GNCB, and this action may have contributed to the above changes in no small measure.

Table 3 (a)
Guyana:
Commercial Banks -
Deposit Market Share (1990-1996)

YEAR	DEMERARA*	GBTI	GNCB	NBIC
1990	-	13.72	40.79	35.58
1991	-	15.31	35.93	NA
1992	-	17.57	29.68	34.75
1993	-	21.42	26.65	43.22
1994	-	21.56	26.59	41.06
1995	3.17	22.42	23.57	37.46
1996	5.17	23.99	NA	33.62

Table 3 (b)
Commercial Banks - Loan Market Share
(1990-1996)

YEAR	DEMERARA*	GBTI	GNCB	NBIC
1990	-	11.12	39.49	11.12
1991	-	16.52	32.17	13.32
1992	-	17.00	17.88	15.32
1993	-	27.79	25.19	29.04
1994	-	34.76	13.14	38.62
1995	2.12	30.54	16.14	37.98
1996	4.12	26.55	NA	28.25

Source: Computed from various Commercial Banking *Annual Reports.*

* Demerara Bank was established in 1994.

When we compare GNCB's operations in the four years prior to its 1995 merger with the two indigenous banks operating in the environment, it is patently obvious that remedial action was necessary. Between 1990 and 1996 the cost-to-income ratios of both GBTI and NBIC evidenced an increasing trend. Similar data are available for only one period in the case of GNCB. Perhaps the increasing cost ratios are a reflection of the expenditure incurred in modernisation of the banks, since during that period more sophisticated computer equipment was being acquired. Increased wages might also have been a factor (See Table 4). Over the same period GNCB's return on assets (ROA) and return on equity (ROE) averaged -4.80 and 1.92 respectively while the corresponding averages for GBTI and NBIC were, ROA; 4.54, 1.94, ROE; 41.4, 35.7 respectively (See Table 5). It is noticeable that in 1991 GBTI achieved phenomenal ROE that resulted from

a devaluation of the Guyana currency which boosted income through a gain on foreign exchange transactions. It is interesting that GBTI with slightly fewer assets than GNCB in 1993 and 1994 recorded profits twelve times that of GNCB in 1993 and thirty times its 1994 profits. It is perhaps an indication of the better use of financial resources and managerial talent (See Table 6).

Table 4
Guyana:
Commercial Banks - Non-Interest Expenses to Total Income*

YEAR	DEMERARA	GBTI	GNCB	NBIC
1990	-	18.44	(-87.8)	23.33
1991	-	10.94	NA	37.83
1992	-	32.23	NA	33.60
1993	-	39.97	NA	38.63
1994	-	49.49	NA	41.34
1995	71.62	52.50	NA	52.39
1996	53.62	43.96	NA	58.82

Source: Computed from various Commercial Banking Reports.

* Total income = net interest income + other incomes.

Table 5 (a)
Guyana: Commercial Banking Statistics - Return on Assets* (1990-1996)

YEAR	DEMERARA	GBTI	GNCB	NBIC
1990	-	5.69	-21.1	2.53
1991	-	12.65	1.31	1.82
1992	-	4.24	-8.91	2.65
1993	-	2.62	0.20	2.00
1994	-	2.60	0.08	2.09
1995	0.66	1.96	-0.40	1.40
1996	1.67	2.03	NA	1.06

Table 5 (b)
Return on Equity (1990-1996)

YEAR	DEMERARA	GBTI	GNCB	NBIC
1990	-	46.12	1.27	56.39
1991	-	107.74	23.9	41.29
1992	-	42.32	-1.46	51.18
1993	-	31.60	5.71	38.88
1994	-	27.62	1.58	29.44
1995	3.43	15.47	-16.93	19.11
1996	14.12	18.89	NA	13.70

Source: Various Commercial Banking *Annual Reports*.

* Demerara Bank was established in 1994.

Table 6 (a)
Guyana:
Commercial Banks - Total Assets (1990-1996)

YEAR	DEMERARA	GBTI	GNCB	NBIC
1990	-	2,162,667	4,847,957	4,826,094
1991	-	4,204,687	7,859,313	7,845,821
1992	-	6,816,789	9,933,880	12,887,836
1993	-	10,265,692	10,761,551	19,971,903
1994	-	11,028,289	11,551,638	19,355,074
1995	2,359,133	14,579,208	16,041,820	22,448,635
1996	4,223,802	19,309,889	NA	23,942,127

Table 6 (b)
Guyana:
Commercial Banks -
Net Income After-Tax (1990-1996)

YEAR	DEMERARA	GBTI	GNCB	NBIC
1990	-	123,052	-1,027,044	121,978
1991	-	532,089	102,676	142,968
1992	-	289,010	-885,468	342,13
1993	-	269,315	21,797	399,814
1994	-	287,052	9,589	403,906
1995	15,634	285,451	-64,392	313,488
1996	70,638	392,391	NA	253,290

Source: Various Commercial Banking *Annual Reports*.

In essence, in 1995, a basically insolvent entity, GAIBANK, was merged with a weak and unprofitable bank, GNCB. The Management at GNCB could not produce good results yet it was entrusted with a larger portfolio, including huge unperforming loans. How was it going to prosper? Perhaps it was not expected to! To merge such institutions without concomitant changes in managerial personnel and operating systems would render the institution ineffective. But this is precisely what happened and consequently the institution is still floundering. GNCB is lagging behind its competitors in many areas, including its use of modern technology.[41] In the case of GAIBANK it was structured in such a way that its mission appeared to be to make loans, though not necessarily to seek good lending opportunities but to provide credit with a view to stimulating economic activity. The fact that it had few good customers, borne out by its negative net worth and an unhealthy loan portfolio, is indicative of how it was perceived by clients. GNCB's portfolio profited from the large devaluations which made huge bad debts into more manageable ones. In 1995, 25% of its portfolio was questionable, and 55.0 % of the classified loans were not performing. In 1997, GNCB's situation worsened. A large proportion, approximately 66-70 % of its portfolio was in rice and in 1997 the rice crop was destroyed by bad weather associated with the *el niño* weather phenomenon. The clients were therefore unable to service loan repayments.

Given GNCB's track record, one would have expected the Government to willingly divest itself of this loss-making entity. It had the opportunity in 1992 when Citizens Bank of Jamaica (CBJ) approached the Government to acquire GNCB as a means of regionalising its operations. Initially, approval was granted for CBJ to undertake a due diligence exercise but before the actual negotiations commenced a general election was called and a new government installed. The new government postponed the discussions but agreed to consider proposals for the establish-

41 The Minister of Finance is reported to have said that the Government's 5-year plan for the institution covers physical appearance, remumeration, computerisation and restructuring, in terms of closure of some branches and staff changes. See *Stabroek News*, September 11, 1997 (pg.3)

ment of new banks. Consequently, Demerara Bank and Citizens Bank were granted licences in 1994. It appears, therefore, that a potentially sound economic decision was reversed in the interest of party politics. It was generally believed that GNCB was an instrument for supporting party faithfuls.

After the merger GNCB's executives estimated that about 200 persons had to be fired. The Bank had been losing market share for basically two reasons: other commercial banks had begun to expand their branch network in areas where GNCB had a monopoly; and the Government's decision to remove restrictions of choice of bank for governmental agencies. GNCB is unable to attract quality staff because its salary structure is not competitive within the industry. Clerks at competing banks receive approximately G$36,000 per month (1999) compared to G$22,000 at GNCB, and salaries of managerial staff do not compare favourably with those of their counterparts.[42] As a result of these inequities, the fundamental weaknesses of the bank were not addressed after the merger, especially in areas of credit and finance administration, and in information technology, where improvements in personnel and in technology were absolutely necessary. There was nothing that GAIBANK added to GNCB that could improve its operating capabilities. It basically brought baggage, and its culture and that of GNCB were incompatible. The classic justification for merging two entities was not present and perhaps the merger was ill advised.[43]

It has been suggested that GNCB survives because politicians use it as a tool to reward supporters. There is the suggestion also that persons who did not support the ruling party have ceased to

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42 A recent survey of salaries at commercial banks revealed that to bring GNCB on par with other commercial banks their salary rates had to be increased by 120%, and that did not include allowances paid by other banks. *Stabroek News*, October 11, 1997 p. 10.

43 A report in the *Stabroek News* of September 11, 1997 p.3 quotes the Finance Minister, Mr Bharath Jagdeo as saying "The Government stuck its neck out and merged two almost bankrupt institutions...." Hence our assertion that the merger was ill advised.

conduct business through the bank for fear that the Government could have access to their records and hence invade their privacy. The Bank is, therefore, suffering because of its perceived association. Can such an institution prosper? It continues to exist, however, because the Government "foots the bill."

The above merger was undertaken due to political intervention but the market model is alive in Guyana and mergers motivated by economic objectives have also occurred. In 1995, the Chairman of Citizens Bank of Jamaica (CBJ) indicated his desire to sell 49% of the bank's shares to locals, at G$10.00 per share. Between 1995 and August 1998, Citizens Bank divested 30% of its shares to locals. In August 1998, three local shareholders met with the Executives of CBJ and a sale was agreed to at G$13.00 per share. Banks DIH, which held 4.5% prior to the sale, acquired 46.5% to increase its shareholding to 51.0%; Continental Agencies Limited, a manufacturing company, increased its shareholding from 5.8 to 15.5%; and Hand In Hand, an insurance company, acquired 10.5% to increase its shareholding to 15.5%. Citizens Bank's market share of deposits is around 5.0% (1998). The bank is effectively controlled by a non-financial conglomerate, whose motives are perhaps not dissimilar to those of the group which now controls GBTI. We speculate that their motives are to ensure that the non-financial entities in the group have easy access to credit.

The foregoing discussion focused on mergers that involved local actors. In 1997, Guyana witnessed its first cross-border acquisition when the Republic Bank Limited of Trinidad and Tobago acquired controlling interest in Guyana's National Bank for Industry and Commerce (NBIC) in October, 1997. The Government of Guyana had decided since 1995 to divest its interest in NBIC. At the time its shareholding was 30% and the National Insurance Scheme (NIS) held 17.5%. This action was in conformity with its Financial Sector Reform Programme promoted by the International Monetary Fund.

Once the decision to divest was made public, the Beharry Group began to target purchases and this increased the value of shares from around G$45.00 per share to G$70.00 per share. Requests

were greater than available shares because the bank was very profitable and this excess demand exerted further upward pressure on the share price. The Government became very cautious, remembering its experience when the Beharry Group acquired controlling interest in GBTI, and this slowed down the process. In the meantime, the Financial Institutions Act was amended to prevent any individual or group from gaining controlling interest in two financial institutions.

In 1997, Republic Bank Limited (RBL) finally gained the foothold it had been after in Guyana since its failed attempt in 1994. In 1994, GBTI and RBL's subsidiary, Finance and Merchant Bank Limited (FINCOR), had virtually sealed an agreement to establish Republic Finance Corporation Guyana Limited, in which FINCOR would own 55% of the shares to GBTI's 45%. Pressure from the Beharry Group for RBL's shareholding to be subordinated to GBTI effectively scuttled the deal. It was, therefore, a major triumph for RBL when it acquired 51% of NBIC's shares, though it paid a premium price, since the shares sold at G$100 as against G$70.00, the price quoted before the sale.

Apart from Republic Bank Limited, there were no other bidders for the entire block of shares. However, there was some difficulty arising out of RBL's request to conduct a due diligence exercise. In September 1997, Guyana's Chief Justice granted two shareholders and *ex parte* injunction ordering NBIC not to implement the terms of the due diligence test. The applicants were seeking to have the court declare that NBIC and its officers were duty bound to confidentiality in respect of customer information, and that a breach of such confidentiality constituted a criminal offence under the provision of Section 63 of the Financial Institutions Act.[44] However, before the matter was heard RBL and the Government rescinded the due diligence agreement and signed the agreement for sale.[45] Republic Bank Limited acquired 47.4% of NBIC's shares, held by the

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44 Story carried in the *Starbroek News*, September 5, 1997 p. 7.

45 *Op Cit*, October 27 1997 p. 2.

Government and the National Insurance Scheme, for G$2.8 billion. The terms of sale included a 10% down payment, a deposit of 25% in an escrow account at the Bank of Nova Scotia, with the remainder comprising a letter of credit from Barclays International.[46] Republic Bank floated a bond in Guyana to raise money to finance the transaction. The initial agreement for acquiring NBIC's shares guaranteed that existing staff would face no threat of retrenchment and that the staff structure would remain intact.

As far as NBIC was concerned, the merger with RBL would allow an acceleration of its improvement plans. Soon after the merger, NBIC's managers began to be trained in Trinidad and IT personnel from RBL's Head Office were engaged at NBIC in streamlining the data processing functions. Initially, most of the changes had been administrative, though special emphasis was placed on customer relations and marketing. Republic Bank had set itself a target of increasing overall market growth by 15% per annum and of increasing market share through aggressive marketing. The acquisition provided RBL with an opportunity to regionalise its network, consistent with its objective of becoming the regional bank of choice.

In terms of initial reactions from some of the stakeholders, these have been generally positive. The majority of staff welcomed the change since they saw it as providing an opportunity for personal improvement. A minority felt uncertain about their status since they wondered whether they could meet RBL's expectations. The staff has expressed satisfaction, especially with the technical competence of the RBL staff whom they have interacted with, and have suggested that through this association their own skills would improve. Republic Bank is known for its emphasis on ensuring that its staff receives high quality training. The customers were pleased that managers were retained since they felt comfortable dealing with friendly faces. They have also

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46 *Stabroek News* October 15, 1997 pp. 1-2.

expressed delight that service has improved and that the trade financing portfolio has been expanded because of RBL's wider network and access to resources.[47]

All of the experience has not been positive, however. During the period preceding the merger there was much uncertainty and this resulted in the loss of market share from about 40% to about 36%. It should be noted here that since the consummation of the merger NBIC has regained the lost market share. Also, during the period under discussion recruiting new staff proved difficult as there was uncertainty about the direction the Bank would take. Since the acquisition there has been a reduction of staff but this has not been directly related to the merger but to the local economic situation.

As we have mentioned to before, we had insufficient data to assess the success of this merger at this time. It should be noted, however, that from the perspective of the Government it has been very successful. In fact, all of the transactions involving the divestment of financial sector holdings have been successfull because the Government has received premium prices for their holdings. In this sense, the country has also benefitted by the boost in the State's finances, and since it is generally believed that private enterprise works more efficiently than state enterprise, the wider society should benefit.

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47 A discussion with the incumbent Managing Director was used as the basis of these remarks.

Chapter 5

Mergers of Financial Institutions in Jamaica

Jamaica's financial system is probably the most developed in the Anglophone Caribbean, given the wide array of financial instruments available through an equally broad network of institutions (see Table 7). Its stock exchange is also the most active, and companies listed far outnumber those of other Caribbean economies. Yet for all of that, its system is regarded as perhaps the most unstable. The Government had to intervene to avert a potentially ruinous event which resulted from lax monitoring and a too rapidly expending sector. The weakness of the Jamaica economy contributed significantly to the crisis which threatened the viability of the financial sector in the mid to late 1990s. Unlike Guyana, the Jamaican financial system has witnessed mergers of credit unions, building societies, insurance companies and banks (both commercial and merchant); some of the mergers were as a result of regulatory intervention and others were through the institutions own initiative.

The operations of financial institutions in Jamaica are on a larger scale than in any other territory in the English-speaking Caribbean. This is primarily because Jamaica's population is twice the size of the next largest Caribbean country, Trinidad and Tobago, whose population is estimated at 1.3 million. This does not necessarily mean that the institutions are larger, in terms of assets size, but their network is wider. It is due to this fact that any potential crisis which impacts the system could have the effect of destabilising the economy.

Table 7
Jamaica: Number of Financial Institutions

INSTITUTION	1975	1985	1990	1995	1997
Central Bank	1	1	1	1	1
Commercial Banks	9	10	11	9	9
No. of Branches (Commercial Banks)	179	155	170	188	171
Trust Companies	NA	NA	3	1	1
Licensed Forex Dealers	NA	NA	NA	98	NA
Life Insurance Companies	NA	NA	10	12	12
Building Societies	NA	6	36	13	13
Co-operative Credit Societies	NA	NA	80	82	73
Development Banks	NA	NA	NA	4	4
Unit Trust	NA	NA	NA	4	4
Investment Companies	NA	NA	NA	NA	10
Stock Exchange	1	1	1	1	1
Finance Companies/ Merchant Banks	NA	8	21	25	29
Stock Brokers	NA	NA	NA	10	10

Source: Research Services Department, Bank of Jamaica.

Credit Unions

In the case of credit unions (CUs), from their inception in 1941 and up to 1967, 132 societies were registered, mainly CUs based on the bond of association.[48] By the late 1960s the Board of Directors of the Jamaica Credit Union League (JCUL), who had been paying visits to international cooperative offices to understudy their operations became convinced that the formation of community credit unions, along the pattern observed in Canada, was desirable for Jamaica. The JCUL Board therefore took a decision to actively promote and encourage community-based credit unions in Jamaica's fourteen (14) parishes. By 1978, the number of CUs declined to 103 societies owing to mergers among organisations operating in the same area.

From 1978 to the time of writing there have been nineteen (19) mergers/amalgamations. However, unlike those occurring before 1978, the recent mergers have been undertaken owing to the country's difficult economic circumstances. Because of the unfavourable economic climate during the 1970s and 1980s, industry-based credit unions began to experience difficulties owing to declining industries. Mergers occurred because the community-based societies sought to assist their less fortunate brethren in distress. Four industrial-based credit unions which were part of declining industries were merged with the City of Kingston Credit Union (COK). Such action is consistent with the cooperative philosophy but this merger was aimed at engendering stability and confidence in the movement. More recently, the large credit unions have passed resolutions allowing them to accept any credit union as a merger partner, thus making it possible for smaller, weaker societies to be merged with stronger ones. In virtually all cases where small CUs have merged with larger ones, there have not been tangible benefits to

48 Credit Unions must be registered with the Registrar of Cooperatives before being recognised as a legal entity. Only twelve members are required to register a society. A bond of association identifies members based on community, workplace or religion.

the larger credit unions. It should be noted, however, that the mergers were undertaken as a means of assisting its "fellow cooperators," not because of economic objectives. An official of the national executive of CUs has suggested that the optimal number of CUs is between fourteen and twenty. He believes that the existing weak management of some institutions coupled with the harsh economic circumstances facing the country could lead to this eventuality. According to the JCUL, between 1995 and 1998 seventeen (17) CUs have been liquidated.[49]

Building Societies

Building societies, while not the same as credit unions, operate by similar principles of cooperation and pooled savings. Their formation mirrors that of the CUs in that they were set up to assist persons of little means to acquire housing accommodation, hence the name building societies. In Jamaica, these organisations have been involved in merger activity through both own initiative and government's urging. The Building Societies Act 15, of 1976 Section 9 (1), provides for the amalgamtion of two or more societies once the terms of the union are approved by a special resolution of each of the societies, among other things.

The expansion of the building society movement during the credit boom period of the early 1960s was concomitant with increased demand for mortgage financing. The number of societies reached 16 at the end of 1971. Batchelor *et al* (1997) contend that in an effort to maintain economic viability and improve services to customers, small societies merged with larger ones resulting in the number of societies declining to 5 by 1989. Jamaica experienced difficult economic circumstances from about 1973 until 1986 when it started to achieve positive economic growth. It was during this period that a number of consolidations took place, largely for economic reasons. It was Oliver Clarke, an

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49 Preliminary statistics provided by the JCUL suggest that at December 1997 there were 73 credit unions, with 522,514 members and savings of J$6.2 billion.

astute businessman and one of the pillars of the movement, who recognised that the future of the building societies depended on larger organisations with strong capital bases. He therefore promoted the idea of mergers to ensure the viability of the movement.

Following the installation of a new government in 1980, the socialist policies of the former administration were reversed and Jamaica began to receive financial support from the international community. The Government was committed to liberalisation of the economy to create a more efficient market-oriented economy. Optimism began to grow in the late 1980s and financial resources began to flow into the economy. In the absence of identified or perceived investible opportunities on the part of holders of financial wealth, individuals and firms found themselves very liquid and hence the financial sector expanded significantly. McBain (1997) put the number of building societies in 1995 at 35. However, she posits that by 1996 only 15 existed owing to mergers among societies and the new licensing procedure for building societies.[50] In one instance the Minister of Finance encouraged the merger of Jamaica National Building Society (JNBS) to First Metropolitan (FM) because the latter was insolvent. The action was supposedly taken to protect the depositors of FM but JNBS saw the opportunity to expand in an area where they had no presence. First Metropolitan was a small operation and after the merger none of its staff was retained. In the case of JNBS' merger with Hanover Building Society, the Boards of both societies met and agreed to the merger. It was seen as another opportunity for expanding business. All staff were retained after the merger. Had this merger not occurred, Hanover would probably not have met the new requirements for operating a society, and might have been closed.

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50 The Building Societies Act was amended in 1995 and it now includes control measures; Capital Adequacy, Auditing and Reporting and other requirements which, if not met, could result in the closure of a society.

Executives in the sub-sector have suggested that the expansion of the number of building societies came about due to weak legislation. However, they contend that the requirements of the new act will force societies to consider mergers as an option if they are to avoid failure and eventual collapse.

Insurance Companies

In the Caribbean much of our economic history has not been recorded and hence we have had to rely on information and anecdotes from persons who actually lived through the events in order to complete this section.

During the late 1960s, the then Jamaica Minister of Finance, Edward Seaga, proposed the localisation of the financial services industry, in particular the insurance industry, within a five-year period. At that time, all of the companies operating in the country were of Canadian origin.

As early as 1974, Calico Jamaica, established in 1972, and National Life of Jamaica commenced negotiations for a merger. By the early 1980s most of the insurance companies were localised but it was in 1982 that the merger was completed with the formation of a new company known as First Life Insurance Company. The new company was initially owned by National Life of Canada, Travelers Corporation of America and Pan Jamaican Investment Trust, which in 1987 acquired the shares of the two foreign companies and thus First Life became a wholly-owned subsidiary of Pan-Jamaican, with National Life and Travelers holding preference shares. Those shares were redeemed in the early 1990s. As a result of further acquisitions the number of insurance companies declined from 20 in 1970 to 12 in 1997.

The insurance sector ran into difficulties around 1993 because of the difficult economic climate. This was perhaps the first sign that the number of service providers was too great for the existing level of business activity. Since then some of the institutions have merged while others continue to seek out suitable partners, but in general there appears to be an unwillingness to speak about mergers, even though most managers appear to recognise

that the economy cannot sustain all of the companies. Most companies did fairly well until 1993 when the economy bottomed out. Premium income dropped from J$400 million in 1993 to about J$160 million in 1996, and rates declined from J$1.00 to about J$0.30. Insurance industry executives believe that most of the existing companies lack the size to be efficient and that they are short of capital. It has been suggested that perhaps only two or three companies will comprise the sector in the near future. One reason proffered for the apparent reluctance by insurance executives to discuss mergers is the fact that current executives were formerly employed by the foreign companies and they fear that through mergers they could lose their power and status. It is therefore believed that merger discussion could commence when their successors enter the boardrooms.

Because of the extremely liquid conditions existing in the country in the early 1990s and the wide array of financial instruments available, people lost interest in the life insurance product and this forced the insurance companies to enter into activities in which their competencies were not as strong. In Jamaica, as well as in Trinidad and Tobago, insurance companies have been well represented in bank ownership but in Jamaica the relationship has been more pronounced and far-reaching. From Table 7 it can be observed that commercial banks dominate the financial system. The banking sector, like the insurance sector, went through a period of nationalisation in the 1970s and 1980s. It was during this period that insurance companies acquired significant shareholdings in commercial banks. Batchelor et al (1997) observe that by the end of the 1970s there were ten commercial banks operating in Jamaica and the local/foreign ownership structure had been significantly altered owing to government ownership and government policy in general. In 1977, the Government established the National Commercial Bank Jamaica Limited to succeed Barclays Bank Jamaica Limited. It remained wholly-owned by the Government until 1986 when 51% of the shares were offered to the public.

During the late 1980s and early 1990s the Jamaican financial sector witnessed significant change. Bonnick (1998) suggests that the most noteworthy change was the rising importance of the

groups. Each group would seek to include a commercial bank, merchant bank, insurance company, building society, investment trust, and leasing company. Some were also involved in both the tourism and agricultural sectors. Bonnick contends that this form of business structure was designed to take advantage of opportunities for minimising the impact of regulations, supervision and taxation upon the group. The financial sector grew rapidly between 1987 and 1995, owing to a significant increase in the number of institutions, which grew from 67 in 1989 to 105 in 1995. The rapid expansion contributed, in part, to the problems which occurred in the mid-1990s.[51]

Commercial Banks

The Government, because of arrangements entered into with the multilateral agencies, began to implement liberalisation policies, and to limit its ownership of state enterprises. In the financial sector, it decided to sell its remaining shares in NCB Jamaica Limited in the late 1980s. The shares were acquired through a joint venture arrangement between Jamaica National Building Society (JNBS) and Jamaica Mutual Life Assurance Society (Jamaica Mutual) in 1993, in a company called M & N Investment Limited. The partnership did not endure as Jamaica Mutual bought out JNBS shares.[52] Jamaica Mutual owned 70 percent of the shares in the Mutual Security Bank (MSB) prior to its investment in NCB (MSB was the successor bank to the Royal Bank of Canada). Effectively, therefore, in 1993 an insurance company had acquired significant interest in two of the country's largest commercial banks. It was owing to this reality that the merger of NCB and MSB took place.

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51 See Bonnick (1998) and Ministry of Finance Paper No. 3, 1998 for further discussion of the factors which contributed to the financial sector problems.

52 Before the arrangement between JNBS and Jamaica Mutual each organisation owned 15% of NCB's shares. After the purchase they jointly controlled about 45% of NCB's shares

The announcement of the merger between National Commercial Bank and Mutual Security Bank was made in 1993. The transaction involved share swaps with little or no cash passing between the institutions. Jamaica Mutual traded its 70% shareholding in MSB for a larger portion of NCB, thereby gaining effective control of the latter. The objectives of the merger were never made clear and hence many observers thought that Jamaica Mutual was caught up in "empire building." Initially it took a decision to operate both banks as separate entities for a trial period of three years before taking a final decision about the merger. At the time of the merger announcement both banks were very high cost institutions, with expenditure to income ratios of 86.3% for NCB and 90.6% for MSB (McFarlane, 1997). Perhaps such statistics led McFarlane to make the following statement: *"With MSB and NCB having the same core competence, there was none of the other usual advantages sought through acquisitions, such as complementarity, diversification, synergy and technology for a competitive edge ....."*

Given the apparent lack of any advantage arising out of the merger, it appears that the decision to merge both banks was ill-conceived. In 1993, both banks were profitable institutions, NCB recording profits of J$420 million and MSB J$150 million. During 1994 and 1995 both banks recorded lower profits and by February 1996 it was realised that both were performing badly. Interestingly, it was suggested that before the merger in 1996 no due diligence test had been conducted on MSB. If this is in fact true, then the decision to merge appears extremely curious and it perhaps contributed to the problems which later emerged. However, when in February 1998 problems emerged, a firm of consultants was called in, and they recommended rationalisation of branches, among other things. McFarlane (1997) contends that the merger was driven by the following:

(i) the need to hasten the cultural integration;

(ii) the burden of maintaining disparate systems and procedures;

(iii) the deficiencies/losses at MSB which were discovered by February 1996, and the deterioration in the results of both banks which were becoming clearly evident;

(iv) the intervening diversion and fragmentation of strategic direction;

(v) the need for cohesive focus as against conflict, because of the larger staff number;

(vi) the pending technology upgrade which unfortunately has been delayed and has contributed to the problem; and

(vii) the need for definitive responses to customer/ market issues.

The merger was effected on October 1st, 1996 when NCB acquired the business, assets and liabilities of MSB. As consideration, NCB issued to its parent group, NCB Group Limited, 1,000,000 ordinary shares of J$1.00 at a premium of J$74.60 per share plus an additional 50,000,000 ordinary shares of J$1.00 each. In accordance with the terms of amalgamation, MSB surrendered its banking licence and ceased to carry on banking business.[53]

Post-Merger Issues

During the rationalisation process which followed the merger, it was discovered that MSB was not as sound as first thought. It appeared to have granted loans on improper lending practices. This, therefore, exacerbated the problem of bad and doubtful debts since NCB had already been known to have a huge questionable loan portfolio, owing to what many believed to be too

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53 Reported in the Financial Statements for the year ended September 30, 1997.

lax a credit policy.[54] Also, the Government had encouraged them to lend to various institutions such as agricultural farms and hotels of which they eventually became owners, by virtue of their clients' inability to repay advances. But worse, they could not liquidate the confiscated assets because the real estate market had all but dried up. Lending policies appeared to be so accommodating that they led to charges of corruption being levied against managers, many of whom were thought to be lending to their friends and to themselves. In view of this, huge provisions had to be set aside for possible loan losses.

There was also a lot of wastage of resources in the attempt to streamline the technology in use at both banks. Foreign consultants from India were contracted to test and implement a new system to replace the existing NCB system which was initially thought to be superior to the one in use at the MSB branches, but which on closer inspection was found to be inadequate to the needs of the merged institution. There was therefore initial wastage in trying to adapt the NCB system to all branches and then huge expenditure in replacing the entire system.

As far as staff was concerned, much had been attempted since 1993 to integrate the two groups of people with a view to cultural assimilation.[55] At the time NCB had a staff complement of 2346 while MSB's staff totaled 1004.[56] The clash of cultures led to much scepticism and speculation, especially among the former MSB staff, and this was not conducive to winning loyalty or to motivation. Instead, staff became highly demotivated and agitated. Persons who were non-unionised became members of the union and a strike was called and the union clamoured for

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54 At the end of financial year 1996 J$879 million had been provided to cover loan losses.

55 McFarlane has given a lot of attention to this aspect of the merger. We therefore refer persons interested in such issues to McFarlane (1997).

56 Scotiabank, the main competitor of MSB/NCB, and Jamaica's second largest bank, employed 1700 persons.

increased benefits. Much was done to appease the staff and to assuage their fears and concerns; cultural and social events were arranged to foster better relations. What could not be avoided, but was being delayed, was a rationalisation of branches and staff as recommended by the consultants.

In 1997, nineteen branches were collapsed into nine, and in 1998 two branches and six agencies were rationalised.[57] Arising out of the rationalisation exercise 220 persons were either made redundant or separated. There were claims that some opted for early retirement while others were forced out, especially at the managerial level. Statistics supplied by the Human Resources Department at NCB reveal that of the persons separated, 67% were former MSB staff members. Of the overall total, 55 were managers and senior executives; of this number 72% were from the former MSB. It has been suggested that managers left on "silver parachutes." Those managers who remained found themselves in positions of lower responsibility, compared to previously held positions, and consequently some of them moved on. The experience of the acquired bank managers is well documented by Sudarsanam, 1997. He contends that for many of them a takeover may mean loss of power status and freedom to innovate, or simply redundancy.

At year end 1996, NCBJ recorded a net income loss before taxation of J$14.3 million. When exceptional items were considered the final outcome for 1996 was a loss of J$215 million.[58] At the time of the merger there were projections for first year savings of J$400 million, with annual net savings of J$587 million arising from the rationalisation exercise, including staff reductions and technology upgrade (McFarlane, 1997). At the end of 1997, after rationalisation of nineteen branches, staff

57 An agency offers limited services, not full service banking.

58 Initially, NCBJ had released its annual report which showed profits after tax of J$126.3 million but after consolidation and restatement of its financial statements following its merger with MSB, a loss of J$215 million was registered.

costs increased by J$300 million, other operating expenses by J$400 million while total operating income increased by J$317 million. There were, therefore, no savings as projected at merger. In fact, at the end of fiscal 1997 a net income loss before taxation of J$368.7 million was recorded. Only a write-back of loan loss provision of J$1.1 billion, consequent to an agreement by the Financial Sector Adjustment Company (FINSAC) to purchase a portion of NCB's non-performing portfolio amounting to J$13.05 billion, allowed a net profit of J$109 million to be achieved. Out of the sum reinstated, 40% was used to write off balances accrued to fraud and forgeries and credit card losses. The profits were used to reduce the accumulated deficit down to J$32.5 million.

When we compare NCB's performance to a group of industry competitors we observe that all of the banks except the Bank of Nova Scotia experienced a decline in net income after tax between 1994 and 1996 (see Table 8a). This was especially acute for all the indigenous commercial banks, in particular NCB, whose net income after tax moved from an all time record high of J$676 million in 1994 to an embarrassingly poor result of negative J$215 in 1996.[59] In contrast, Nova Scotia's net income after tax in 1996 showed a 15.4 percent increase over 1994, while the Canadian Imperial Bank of Commerce (CIBC) though recording a 48.8 percent decline over the period still out-performed all the indigenous banks. CIBC's performance should be noted since in terms of asset size it is the smallest of all the banks considered (see Table 8b). On examination of Table 9, however, it is clear why CIBC outperformed the others; its level of operational efficiency was generally superior to most banks.

59 McFarlane (1997) refers to the profits posted in 1994 as NCB's best ever year and the results achieved in 1996 as NCB's worst ever year (see pg.74).

Table 8(a)
Jamaica:
Net Income After-Tax -
Selected Commercial Banks (1990-1996)

YEAR	BANK OF NOVA SCOTIA	CIBC	CITIZENS BANK	NCB	WORKERS S&L
1990	132,082	37,347	13,815	62,067	-39,076
1991	188,391	77,383	30,906	105,970	3,512
1992	413,711	148,552	53,603	162,397	NA
1993	522,942	134,586	61,900	289,270	35,925
1994	1,221,803	203,917	77,958	676,704	69,546
1995	1,178,071	183,497	7,114	397,245	13,790
1996	1,410,681	104,361	-575,091	-215,008	NA

Source: *Annual Reports* of Commercial Banks.

Table 8(b)
Jamaica:
Total Assets - Selected Commercial Banks (1990-1996)

YEAR	BANK OF NOVA SCOTIA	CIBC	CITIZENS BANK	NCB	WORKERS S&L
1990	4,729,751	1,115,743	1,509,742	5,552,964	670,971
1991	6,363,966	1,745,413	2,529,385	7,759,578	1,202,863
1992	10,469,092	2,688,695	5,475,829	14,884326	2,476,712
1993	14,927,311	3,632,707	6,265,669	18,795,643	3,619,350
1994	22,077,146	4,846,101	8,032,060	28,220,054	5,559,093
1995	33,210,192	6,972,467	8,679,441	34,483,198	7,359,683
1996	36,770,730	8,201,625	7,630,480	57,021,480	NA

Source: *Annual Reports* of Commercial Banks.

Table 9 (a)
Jamaica:
Non-Interest Expense to Total Income* (%) - Selected Commercial Banks (1990-1996)

YEAR	BANK OF NOVA SCOTIA	CIBC	CITIZENS BANK	NCB	WORKERS S&L
1990	57.94	138.22	NA	77.45	227.42
1991	56.58	47.15	74.47	75.73	92.80
1992	47.72	43.82	77.61	72.69	NA
1993	54.11	56.53	84.15	71.94	90.86
1994	44.92	54.42	99.32	63.79	85.03
1995	43.08	61.57	98.08	79.88	96.76
1996	51.68	78.40	191.22	100.33	NA

*Total Income = Net Interest Income and other Operating Income.

Table 9 (b)
Jamaica:
Non-Interest Expenses to Total Assets (%) - Selected Commercial Banks (1990-1996)

YEAR	BANK OF NOVA SCOTIA	CITIZENS CIBC	BANK	NCB	WORKERS S&L
1990	5.10	14.14	6.49	5.77	10.09
1991	5.24	5.25	6.90	6.47	8.68
1992	5.63	6.40	5.63	4.87	NA
1993	5.54	6.87	8.60	5.74	9.69
1994	6.69	7.67	8.44	6.14	8.08
1995	4.49	7.19	9.16	7.65	8.46
1996	6.21	7.24	12.41	7.66	NA

Source: Computed from Financial Statistics in *Annual Reports*.

Most individuals seemed inclined to attribute the poor performances to factors affecting the local economy. While such suggestions have merit we support Bonnick (1998) who believes that weak management and control policies were largely responsible, since the foreign controlled banks not only "weathered the storm" but did relatively well. When we examine the ROA and ROE statistics (Table 10) it is clear that the indigenous banks were being outperformed even though in all cases, except for Nova Scotia, the trend has been declining, in some cases very sharply. One year after the merger, therefore, NCB's performance worsened but its difficulties were compounded by problems affecting the overall financial sector, problems which by 1997 had become widespread and were threatening the health of the entire economy. We now provide a brief summary of those events.

Table 10 (a)
Jamaica:
Return on Assets -
Selected Commercial Banks (1990-1996)

YEAR	BANK OF NOVA SCOTIA	CIBC	CITIZENS BANK	NCB	WORKERS S&L
1990	2.79	3.35	1.87	1.12	-5.66
1991	2.96	4.43	2.03	1.37	0.29
1992	3.95	5.53	1.66	1.09	NA
1993	3.50	3.70	1.46	1.54	0.94
1994	5.53	4.21	0.97	2.40	1.25
1995	3.55	2.63	0.08	1.15	0.19
1996	3.84	1.27	-7.54	-0.37	NA

Table 10 (b)
Jamaica:
Return on Equity -
Selected Commercial Banks (1990-1996)

YEAR	BANK OF NOVA SCOTIA	CIBC	CITIZENS BANK	NCB	WORKERS S&L
1990	45.93	38.27	50.94	24.76	-389.28
1991	50.90	48.43	38.40	33.52	3.28
1992	71.21	55.09	49.80	36.36	NA
1993	62.89	39.31	41.31	40.16	16.06
1994	59.88	42.95	27.68	52.51	29.35
1995	44.13	30.28	2.55	28.81	5.79
1996	41.23	15.85	-	-10.7	NA

Source: *Annual Reports* of Commercial Banks.

Problems in the Financial Sector

In July 1996 representatives of the Life Insurance Industry approached the Government and requested assistance to address problems which had emerged in that sub-sector and spilled over into the commercial banking sector. The latter was possible because insurance companies held significant banking assets and banks in turn owned hotels and companies in the productive sector. It was owing to a contagion effect therefore, that the problems in the insurance industry began to affect related sectors (Bonnick, 1998). What was the genesis of the problem?

In the late 1980s the Jamaican economy was performing relatively well; real GDP averaged 5.72 percent annually between 1987 and 1990. During the period 1991 to 1995, however, the gains of the previous period were lost and real GDP had slipped to average 1.2 percent over that period. By 1996 growth became

negative and thus the business sector's confidence was further shaken. McBain (1997) contends that the high inflation rates and the negative real interest rates led to significant growth in real estate and the stock market but not in overall productive activities (see Table 11). In the early 1990s insurance companies engaged in a number of injudicious investments, and banks undertook investments outside their core activities. For instance, Jamaica Mutual began purchasing hotels, it pursued housing development, built a new head office complex and purchased several other properties which led to its becoming "cash short" and probably highly leveraged. Some banks borrowed expensive money to finance the purchase of buildings; some even paid interest on current accounts, deposits which traditionally did not attract interest. Banks became very lax in their lending policies, especially indigenous banks, and consequently there appeared to be too much conspicuous consumption.

When the Government began to take corrective action to dampen inflation in 1993/1994, banks which had invested heavily in real property were in trouble. Their clients could not meet commitments to the banks because of extremely high interest rates which reached a peak of 49.60 percent in 1993 but averaged in the high forties for most of the early to mid-1990s (Table 11 refers). Banks were therefore left holding significant real property which they found difficult to liquidate. The following quote from McFarlane (1997) is revealing:

> "Perhaps the NCB Group sold more real estate in Jamaica than any other over the last year, although we did not sell half as much as we would have wanted to sell, perhaps, not half as much as we needed to sell" (p.64).

The downturn in the real estate and stock markets resulted in the closure of a number of financial institutions. The Blaize Trust Group ran into difficulties in 1994 forcing the Government to establish the Financial Institutions Services Limited (FIS) to sort out their problems. In 1995, the Century National Bank could not meet its obligations to depositors. It was put under temporary management by the Minister of Finance and

Table 11
Jamaica:
Selected Macroeconomic Data (1991-1997)

YEAR	1991	1992	1993	1994	1995	1996	1997
Growth Rate Real GDP	0.9	1.6	1.7	1.1	0.7	-1.3	2.0
Inflation (Annual Avg)	51.1	77.3	22.1	35.1	19.9	26.4	9.7
Comm. Banks Loan Rate (Weighted Average)	34.03	46.04	49.60	45.79	48.56	37.81	31.93
3-mth Deposit Rate (Avg)	29.9	23.7	42.6	31.21	25.98	22.17	13.76

Source: Bank of Jamaica.

subsequently closed in early 1996. In 1996, there was a run on Citizens Bank Limited, perhaps triggered by a fear of repetition of the recent events in the sector (Bonnick, 1998). All of these events stirred a crisis of confidence in the financial system, something which the monetary authorities could ill afford.

The Minister of Finance in a "Public Response to the Problems of the Financial Sector" identified the following as factors contributing to the problems:[60]

(1) Rapid expansion of the sector. In 1980 there were thirty six licensed financial institutions with total assets of J$2.5 billion. By 1996 the number stood at 57 with total assets of J$192 billion;

(2) Structural reform which created new avenues for profit from foreign exchange trading and securities trading, and a real estate boom which encouraged institutions to invest heavily in the real estate sector;

(3) The existence of an inflationary environment which facilitated rapid growth in profitability while at the same time masked weaknesses in the sector. These weaknesses emerged once the anti-inflationary policies were put in place;

(4) The rapid expansion placed severe strains on available management expertise. The institutions began to exhibit serious management weaknesses in the areas of planning, capital controls, risk/ credit assessment and monitoring, high and increasing non-performing assets, flagrant dishonesty; in the sole interest of the major shareholder and/or the latter's associates and

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60 See Ministry Paper #3 of 1998 by Omar Davies, Minister of Finance and Planning April 8, 1998.

ineffective supervision of the management by the Board of Directors.

Bonnick (1998) believes that the above reflect only part of the answer since foreign banks operating in the same environment did not experience the problems which indigenous commercial banks did.

The Minister of Finance invited a team of consultants to determine the nature and extent of the problems and to develop appropriate solutions.[61] The team concluded that the problems resulted from the following:

(a) A mismatch of assets and liability maturities - short term deposits were used to purchase long term assets such as real estate. Many of the domestic financial institutions did not possess the capability to assess the risks and consequently they were left holding real estate they could not dispose of to meet their short-term obligations;

(b) Banks and insurance companies entered sectors in which their management did not have the requisite skills or experience;

(c) When lending to related parties or parties under common control, the banks and insurance companies made poor or biased credit decisions and invested in companies on a less than arms-length terms resulting in poorly secured loans;

(d) Investments in non-core business had to contend with an unsustainable capital structure and relied heavily on high cost loans with relatively short maturities.

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61 See speech of Minister of Finance and Planning April 8, 1998.

The team recommended that Government should intervene to comprehensively address the problems of liquidity and insolvency, as well as the related problems of weak management, the structure of ownership and control and the regulatory framework. The Government established the Financial Sector Adjustment Company (FINSAC) in January, 1997 to undertake those functions. FINSAC embarked upon a three-phased course of action:

(i) to infuse fresh capital into ailing banks and life insurance companies in exchange for equity and board seats;

(ii) to rationalise and reorganise the entities intervened, its goal being to sustain depositor and policy holder confidence in Jamaica's insurance and banking sectors by strengthening their credit evaluation systems and loan portfolio management;

(iii) to return in a quick and orderly fashion all FINSAC assets into private hands. This is expected to be completed by 2005.

We believe that it was necessary to provide some background to the establishment of FINSAC since this institution has been required to play a very critical and pivotal role in restoring confidence in Jamaica's financial system, and in rehabilitating the distressed financial institutions. By 1997 another indigenous commercial bank, Workers Savings and Loan Bank, also experienced a run by depositors and this institution had to receive assistance from the Government. Worse was yet to come. Towards the end of 1997, just barely one year after its merger, the largest bank in the country, NCB, with 45.0 percent of the deposit market share, slipped further into trouble, largely on account of its unhealthy loan portfolio, and had to be rescued by FINSAC. It should be emphatically stated, however, that NCB's problems cannot be attributed to its merger though it is perhaps true that following the merger it became a weaker institution. It was saddled with a huge portfolio of bad and poorly assessed loans.

Because of NCB's size, the Government perhaps treated it with some deference. Jamaica Mutual and Life of Jamaica were required to divest their holdings in the commercial banks, NCB and Citizens Bank respectively, to concentrate on their insurance business. FINSAC acquired control of those banks in order to restore them to health. In late 1997 NCB entered into an agreement with the Government, FIS and the Century Financial Entities (CFE) - which had been declared insolvent by the Minister of Finance - under which it assumed the liabilities, consisting mainly of deposit accounts of the CFE of approximately J$6.3 billion of which $1.8 billion represented the Jamaica equivalent of foreign exchange balances.[62] The NCB would provide new deposits created by itself, to be matched by notes issued by FIS in Jamaica and United States denominations which would be negotiable and guaranteed by the Government. Those in US currency would bear interest at 9.625 percent per annum while those in Jamaica currency would bear interest at 1.0 percent above the weighted average applicable to the most recent treasury bill (six-month). Funds withdrawn from deposits would be reimbursed to the bank by sale of the notes.

FINSAC is therefore using the services of NCB to make deposits available to the affected customers. This action was necessary in the absence of deposit insurance. However, the Deposit Insurance Act was passed in March 1998 and soon depositors will be provided protection through the Jamaica Deposit Insurance Corporation. When this agency is fully operational both FIS and FINSAC should be wound up. In the interim, however, its services are still essential. The total cost of intervention by FINSAC to April 1998 amounted to J$73.5 billion, of which J$11.8 billion has been financed by cash transfers from the Consolidated Fund to clear overdrafts in the Bank of Jamaica and J$62.6 billion by government paper.[63] Eagle Commercial Bank,

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62 For more details on this agreement see NCB's Annual Report for the year ended 1997.

63 See Ministry Paper No. 3 for more details, April 8, 1998.

Workers Savings and Loan Bank, and Citizens Bank had slipped into overdraft at the Central Bank when faced with demands from depositors.

At the end of fiscal 1997 Jamaica Mutual sold its shares (44.8%) in NCB Group limited to FINSAC. Subsequently, by a letter dated April 29 1998, FINSAC committed itself to rendering financial assistance to the NCB Group. It agreed to purchase from the bank, through its wholly-owned subsidiary Recon Trust Limited, non-performing loans amounting to J$13.05 billion, on a non-resource basis. In exchange FINSAC would issue bonds having an aggregate principal value of the same amount. The NCB will act as collection agent and portfolio manager for the said loans.[64] With the assistance being provided to NCB, FINSAC has now effectively intervened in all the indigenous commercial banks. It, therefore, has placed the Government in a situation from which it attempted to divest itself not long ago, the ownership of financial institutions, though its decision on this occasion was based on totally different circumstances. Government's support through FINSAC has resulted in the protection of 1.5 million deposits valued at J$68.7 billion, and 569,000 individual policies, assured for J$174.4 billion.[65]

The issues related to the failure of indigenous banks in Jamaica are many, and require a separate study. Any treatment that we provide in this work can at best be superficial since our focus was not on the "crisis" *per se* but the mergers which occurred. In that context, Trans America Financial Services has been employed to rehabilitate and to merge the four failed banks into one entity. Citizens Bank Limited/Horizon, Eagle Commercial Bank, Island Victoria and Workers Savings and Loan Bank will all form a new entity known as the Union Bank Holding Company. According to a press report, the Minister of Finance has said that the new

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64 For further details regarding FINSAC's assistance to the NCB Group see p. 23 of Financial Statements, 1997.

65 These statistics were provided in Ministry Paper No. 3 of 1998.

entity would emerge as Jamaica's third largest bank after the Bank of Nova Scotia and NCB.[66] Already, the Government has committed J$80 billion to the restoration of the banks. The Union Bank with assets of J$38 billion would be divested as soon as government gets a suitable offer.[67]

In the case of Jamaica, therefore, recent merger activity has been motivated by the crisis in the financial system and has been promoted by the Government in order to restore stability and confidence in the financial sector. The costs to taxpayers have been tremendous but, significantly, any benefits to be derived would redound to the entire society. The resources used in rescuing the troubled banks have been considerable. It raises the question as to whether the Government ought to have committed itself to the extent that it did, financially. Of course, because of the gravity of the situation, the authorities cannot be faulted for their intervention but we believe that moral hazard should always be allowed to work as a check on commercial bank managers. By fully committing themselves, the authorities appeared to have removed such hazard from the managers. Perhaps with a lower level of financial commitment some of those resources could have been used more effectively in transforming the economy and reducing poverty. The social circumstances in Jamaica are tenuous. Whether the costs and sacrifices made have been worth it is left to be seen.

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66 See report in the *Trinidad Express* of December 7, 1998 p. 14.

67 *Ibid.* p.14.

Chapter 6

Financial Sector Mergers in Trinidad and Tobago

In the early 1990s, the Government of Trinidad and Tobago announced that it wanted to establish its country as the financial centre of the Caribbean. Trinidad and Tobago's financial system is relatively well-developed by developing country standards and because of the recent "crisis" in Jamaica it may well claim unofficially to be the region's premier financial centre. Though it has not experienced a "crisis" as severe as Jamaica's it, too, has had its problems, especially among the non-bank financial institutions (NFIs) in the 1980s. What is certain, however, is that financial institutions from Trinidad and Tobago have been more aggressive and perhaps more adventurous than those from other regional economies in expanding outwards.

Like all of the countries in the Anglophone Caribbean, which were colonised by the British, Trinidad and Tobago's financial sector, especially banking, started off with the Colonial Bank, later Barclays Bank. By the early 1900s Canadian banks made their entry, and the American banks followed in the 1960s. All of the countries, therefore, featured a combination of foreign banks but the British and the Canadian banks were more prominent. The insurance sector was also largely comprised of foreign companies. Both in Trinidad and Tobago and Jamaica, insurance companies have held significant ownership interest in commercial banks but this occurred only when such institutions were being nationalised. Robinson (1988) believes that the Banking Act of 1964 and the Central Bank Act of 1964 marked a watershed in the development of banking in the

country.[68] Forde *et al* (1997), however, contend that in many respects the year 1970 represented a watershed in the economic, financial and social history of the country. Both Robinson, and Forde et al may be correct in their assessment, as these separate events impacted significantly on the financial landscape. The Acts provided the legal framework within which banking could grow while, the so-called "Black Power Revolution" helped to change the shape and composition of banking.[69] One possible effect of the disturbances is that it may have forced the authorities into appointing a black man to head a commercial bank, something unheard of at the time.

During the 1970s the insurance and banking sectors became the focus of efforts to localise the domestic financial sector. The Government's policy on localisation was clearly enunciated in its third five-year plan 1969-1973, approved by the Cabinet in 1969. Its policy was to develop local financial institutions in competition with the foreign banks, as well as urge the foreign banks to incorporate locally and to sell shares to nationals (Scotland, 1988). In February, 1970 a group of university students in Trinidad, in expressing their solidarity with students involved in protest action at a Canadian university, organised themselves and a largely Afro-Trinidadian following into what became known as the "Black Power Revolution." Foreign commercial banks were targeted for protest action because of their hiring practices, which tended to exclude the two main ethnic groups. This had a positive impact in Canada where the Canadian banks operating in Trinidad and Tobago began to train Caribbean nationals to occupy managerial positions in the

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68 The Banking Act which took effect in 1965 aimed to regulate the licensing and operation of commercial banks while the Central Bank Act which took effect in December 1964 set up the monetary authority to supervise these institutions.

69 For an account of the "Black Power Revolution" see *The Black Power Revolution 1970, A Retrospective*. Selwyn Ryan and Taimoon Stewart eds., 1995.

foreign based institutions.[70] Perhaps the events of 1970 accelerated the localisation process and it partly explains why two Canadian banks were among the first financial institutions to sell shares to the local public (Scotland, 1988).[71]

The economic success of the 1970s to early 1980s spawned a number of non-bank financial institutions (NFIs) anxious to cash-in on the extremely liquid conditions.[72] These institutions were established and grew rapidly in an environment which was, until 1981, completely unregulated (Farrell, 1988). From Table 12 one can observe the significant increase in financial institutions between 1973 and 1985. Forde et al (1997) believe that the failure of some of them was a direct consequence of the end of the economic boom. What is interesting, however, is that the downturn in economic fortunes did not coincide with mergers in the financial sector as have occurred both in Guyana and Jamaica. An initial round of acquisitions in banking occurred in the early 1970s mainly by the State, to be followed several years later by acquisitions in the insurance sector. During the 1990s, however, we have witnessed perhaps the largest number of acquisitions throughout the region, including cross-border acquisitions by Trinidad and Tobago banks. There has been very little merger activity by financial institutions outside of the insurance and banking sectors though two credit unions have recently merged.

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70 See Scotland, 1988 for more detailed discussion.

71 The Royal Bank of Canada and its associate the Royal Bank of Trinidad and Tobago began to sell shares in July, 1973, while the Bank of Nova Scotia commenced in December, 1973. CIBC started rather late in May, 1980.

72 Trinidad and Tobago enjoyed boom conditions between 1974 and 1982 owing to extremely high international prices for its main export commodity - oil and petroleum related products.

Table 12
Trinidad and Tobago:
Number of Financial Institutions

Institutions	1975	1980	1985	1990	1995	1997
Central Bank	1	1	1	1	1	1
Commercial Banks	9	9	8	8	6	7
No.of Branches - Commercial Banks	91	105	117	121	117	119
Trust Companies	5	NA	8	7	6	6
Insurance Companies	57	60	57	56	42	NA
Cooperative Credit Societies	NA	420	381	404	398	NA
Development Banks	3	3	3	3	2	NA
Savings Banks	4	4	4	4	4	NA
National Insurance Scheme	1	1	1	1	1	1
Unit Trust	0	0	1	1	1	1
Stock Exchange	0	1	1	1	1	1
Finance Companies/Merchant Banks	NA	12	14	12	10	10

Source: Central Bank of Trinidad and Tobago; *Annual Report*, Supervisor of Insurance.

Credit Unions

In the credit union (CU) sub-sector mergers between financial cooperatives have been rare, with only two such occurrences between 1975 and 1997. More recently a number of societies have been pursuing exploratory discussions, perhaps owing to suggestions by the regulatory body for cooperatives that weak and floundering organisations should seek to merge as a means of avoiding failure. Nothing concrete has resulted from these discussions, however. The first credit union merger that we are aware of occurred in 1975 between the Bermudez Employees Credit Union and the Aranguez Industrial Estate and Community Credit Union, creating what is now known as Eastern Credit Union. At the time of the merger Bermudez had a membership of 25 persons and assets of TT$58.50 while Aranguez had assets of approximately TT$5000.00 and membership of about 95 persons. Aranguez saw the merger as an opportunity to widen its membership base as it had hopes of enlisting the support of all workers on the industrial estate, which at the time comprised a number of small industries. It took several years for Eastern to become well-established but its progress was helped by the favourable economic circumstances in the country between 1974 and 1982 and by government incentives, which were aimed at promoting savings through that sub-sector. Eastern Credit Union is now widely recognised as the leading credit union in the country with assets of over TT$300 million, probably 20% of the assets of the entire credit union system, which comprises about 150 active credit unions.[73]

After a period of almost 22 years another credit union merger occurred in 1997. Hydro Agri and Grastaff Credit Unions, after signing a memorandum of understanding in April 1996, merged their operations in 1997. The decision to merge was taken approximately four years after it was first proposed and was preceded by lengthy discussions at the board level and with the

73 Recent estimate provided by the Trinidad and Tobago Cooperative Credit Union League.

approval of the general membership. Perhaps it was inevitable that the two organisations would merge as they originated from within the same company. Both Hydro Agri and Grastaff were established in the 1960s by the employees of Federation Chemicals Limited; the former was based in Central Trinidad while the latter was based in Port of Spain.[74] According to a merger document "Going Forward Together" produced by both organisations and circulated to the general membership, the idea of amalgamation began informally as a means of strengthening and expanding the human and financial resources of both entities. Further, the need to amalgamate became inevitable in 1993 as the economy and the policy direction of the Government changed owing to conditionalities imposed by the multi-lateral lending agencies.[75]

The procedures to be adopted for credit unions wishing to amalgamate are outlined in Section 53 of the Cooperative Societies Act of 1971, Chapter 81:03. A resolution passed by a three-fourths majority of the members present at separately convened Special General Meetings of both societies and approval from the Commissioner for Cooperative Development are essential to the process. These requirements were met by both organisations and consequently the successor institution, Venture Credit Union, was registered on March 3, 1997. At the time of the merger Hydro Agri's staff comprised three permanent employees while Grastaff had a complement of four permanent staff members and two employees on contract. A decision was taken that no permanent staff would be retrenched, and that the new entity would have an expanded organisational structure to cater for the increased demands anticipated. A review of both organisations revealed that they had a lot in common, with the major difference relating to loan policy. Adjustments were made to enhance those facilities in the new organisation.

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74 Hydro Agri Credit Union was, until 1991, known as Fedchem Credit Union. Its name changed after Federation Chemicals Limited became a subsidiary of Norwegian-based Norsk Hydro.

75 The Government removed in 1997 a tax incentive which credit unions enjoyed and used as a successful marketing tool to attract savings.

In order to determine if the merger was successful we shall provide some comparative statistics before and after the merger. At the end of 1995, thirteen months prior to the merger, total assets of both credit unions combined amounted to TT$40.3 million, with Grastaff's share of the assets around 80%. Total surplus amounted to TT$2.6 million, with Grastaff's contribution being 87%.[76] The combined revenue statement showed that at December 1995 the expenditure/income ratio was 37%, with individual rates of 31% for Grastaff and 57% for Hydro Agri. When we examine the ratio of personnel costs to total income, Hydro Agri at 24% was more than twice Grastaff's ratio of 11%, though the joint ratio was 13.7%. These statistics appear to suggest that a small, relatively inefficient organisation was being merged to a much stronger and efficient unit.

Thirteen months after the amalgamation total assets increased by 40% to reach TT$56.7 million, while surplus increased by 23% to reach TT$3.2 million. The operating cost ratio increased from 37% to 40%, while the personnel cost ratio increased from 13.7% to 16.3%. What these figures appear to show is that members' confidence in the new entity allowed them to invest more heavily in the institution, hence the increased assets and surplus. However, the level of efficiency seemed to have declined marginally. The most recent figures reveal that at March, 1999 total assets continued to increase, though the rate of growth slowed to 14.4%, while the rate of growth of surplus outstripped the previous period to reach a 38.6% increase. Even more impressive were the reductions achieved in both the operating cost ratio and the personnel cost ratio which declined to 38.6% and 11.6% respectively. It appears that thus far Venture Credit Union has enjoyed a successful amalgamation. Its achievements in the areas of surplus and operating ratio are good when compared to the majority of CUs whose rate of growth of

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76 In the Credit Union sector the tendency is to use the term "surplus" rather than "profit" since the institutions claim to be non-profit organisations.

profitability is generally below 20%, and whose operating cost ratio is generally over 50%.[77]

Non-Bank Financial Institutions

In the NFI sub-sector we know of no recorded merger activity, though there has been a rapid expansion of institutions as well as some closures. In 1973 there were four (4) Trust and Mortgage Finance Companies. By 1984 their number had increased to eight largely on account of a property boom associated with a very liquid economy. Farrell (1988) suggests that a consequence of the "boom times' was that poor management of business was masked, as were poor lending and credit control practices in the finance companies, by the profits achieved. Once the boom was over weakly managed and controlled finance companies began to show signs of failure.

In 1983, the Chief Executive Officer of International Trust Limited (ITL) was fined several million dollars for charges in respect of alleged breaches of the Exchange Control Act. This action caused a run on ITL and resulted in the suspension of its business in September 1983 by the Central Bank. In 1984, another company, Southern Finance, also had its operations suspended. These incidents shook confidence in the financial system, especially confidence in finance companies not affiliated to commercial banks (Farrell, 1988). In order to restore confidence in the system commercial banks joined with the Central Bank in providing liquidity support to the troubled institutions.[78]

By 1986 four finance companies were closed by the Central Bank: South Western Atlantic Investments Trust Limited; Summit Finance Limited; Commercial Finance; and Trade Confirmers

77 See Khan, 1998 for an analysis of industry operating cost ratios.

78 Farrell (1988) notes that up to July 1986 such support amounted to TT$42.7 million.

Limited, while another was under close scrutiny.[79] In pursuing corrective measures the Central Bank Act and the Financial Institutions Non-Banking Act were amended in 1986 to provide for increased supervisory surveillance by the Central Bank. Also in 1986, the Central Bank established the Deposit Insurance Corporation (DIC) in direct response to the failure of the NFIs, but more specifically to provide depositors with an agency capable of providing relief without having to access taxpayers' resources.

Insurance Companies

In respect of insurance companies, they have perhaps been involved in greater merger activity than commercial banks, though the transactions have tended to be a lot smaller and of less public concern, probably because of their greater number.[80] Between 1966 and 1977 a number of Canadian companies had localised their operations, consistent with government's policy as alluded to earlier. The Government sought initially to rely on the use of moral suasion to achieve its objective but when insurance companies appeared to be slow in responding, fiscal incentives were introduced in 1975, resulting in a largely locally-owned industry (Forde et al, 1997).[81]

In 1977 Colonial life Insurance Company (CLICO) acquired the local operations of Confederation Life of Canada. There was little objection to the acquisition except that the local sales force was split, half going to CLICO and the rest to Barbados Mutual. It was believed that the split was done along racial lines, since CLICO was perceived to be a "black-based" organisation while Barbados Mutual was perceived to be a "white-based" company.[82]

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79 It is widely believed that a forensic audit found the institutions to have severe cash flow problems because of mismanagement.

80 At the end of 1996, the local insurance sector comprised forty-six institutions (life and general) while banks numbered six.

81 The authors contended that the industry is highly concentrated with the ten largest firms, in 1993, accounting for 78% of total assets.

82 CLICO was the first local insurance company to be established by a Trinidadian, Cyril Duprey, in 1936.

Between 1977 and 1991 there were no actual mergers or acquisitions but owing to the relatively depressed economic conditions after 1982 a number of the smaller companies came under tremendous pressure. Indeed, some failed, especially the general insurance companies. For instance, in 1988 the West Indian National Insurance Company Limited (WINSURE) was closed and 100 employees sent home. It was not able to pay taxes to government or to honour claims to its clients.[83]

In 1991, Guardian Life of the Caribbean Limited (Guardian Life) acquired all of the issued ordinary shares of Crown Life Caribbean Limited. The main objective of the acquisition was to double its in-force business in order to reduce the unit cost of policy administration and to optimise its operations through greater economies of scale.[84] Consequent to the acquisition its sales force expanded to 280 persons and its share of the life insurance market increased from 22% to 31% at the end of 1992. Guardian Life appeared to have pursued its expansion plans after realising an after-tax loss of TT$3.9 million in 1989. But its expansion had only just begun. Early in 1993 it acquired a portfolio of life insurance business in Curacao and Aruba through insurance agencies operating in those jurisdictions, and in mid-1993 it opened a branch office in The Bahamas staffed by a group of the leading sales persons from the islands.[85] These activities paid dividends in a relatively short period of time: profits after-tax jumped from TT$5.0 million in 1992 to TT$16.9 million in 1994.

On December 29 1993, Guardian Life became a subsidiary of Jamaica Mutual Life Assurance Society Limited (Jamaica Mutual) when the latter acquired 44% of its shareholding. Jamaica Mutual's shareholding was reduced to 20% in 1995 when it sold 24% of its interest in Guardian Life to the Royal Bank

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83 Reported in *Trinidad Guardian*, March 22, 1988 p.1.

84 See *Annual Report* of 1992

85 See *Annual Report* of 1993.

of Trinidad and Tobago for TT$76.4 million in cash. The latter had earlier in 1995 formed an alliance with Guardian Life when it purchased 50% of Crown Life's assets for TT$36.4 million and Guardian Life acquired 15% of Royal Bank's share capital. These companies subsequently entered into a joint venture arrangement through which they proposed to offer integrated personal financial services to the local and regional markets, through Banc Assurance Caribbean Limited.[86] Guardian Life's expansion and acquisition policies have made it into one of the largest insurance companies in the country, perhaps the region. In terms of gross premiums for ordinary life insurance it has enjoyed primacy over competitors in both 1996 and 1997 (see Table 13). Its acquisition strategy seems to be aimed at increasing its market share, broadening its income base and positioning itself as the leading service provider in its field. It may well be achieving those goals.

In November, 1997 Demerara Life Assurance Company (Demerara) and Mega Insurance Company Limited (Mega) were merged following agreement reached between both parties in November 1995. Both companies were wholly-owned subsidiaries of companies established in Guyana.[87] Prior to the transaction Mega had increased its capital, allowing it to trade 50% of its shareholding to Demerara Life (Guyana) for 100% of its subsidiary in Trinidad and Tobago. At the time of the merger both companies were on par in terms of asset size but Demerara was writing little business and its premium base was declining rapidly (it declined from $5 million in 1996 to $4 million in 1997) while Mega's premium base was expanding rapidly (it increased from $20 million to $22 million between 1996 and 1997). It was expected that by merging they would realise costs savings in most areas owing to rationalisation of administrative and technical functions. In fact, costs savings of approximately TT$7.0 million were achieved between 1996 and 1997 and a

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86 See Royal Bank *Annual Reports,* 1995 and 1996.

87 Mega was previously known as Guyana and Trinidad Mutual Life but changed its name in the 1980s.

projection for savings of $3.5 million made for 1999 from the reduction in rental of computer services.[88]

Prior to the merger both companies were at the lower end of the insurance industry in terms of market share of premiums (See Table 13). By combining forces they have climbed to mid-table. As far as Mega is concerned the merger has allowed it to expand its operations, reduce costs and increase its income and assets. It continues to pursue strategic alliances with other companies in areas in which it needs improvement. Its Chief Executive Officer believes that the optimal number of insurance providers for the country is between six and eight and hence he expects merger activity to continue.[89]

Colonial Life insurance Company (CLICO) is by far the most aggressive regional insurance company in terms of its growth strategy. It has set up operations in virtually all the Caribbean territories, stretching from The Bahamas in the North to Guyana and Suriname in the South. Its parent company, CL Financial Limited, is probably the region's leading conglomerate with ownership interests in companies of varying degrees of sophistication, from the production of petro-chemicals to retailing of foodstuff. Its core business, however, is the provision of financial services; in particular, insurance services. It also holds significant ownership interests in the banking sector, about which more will be said later. The company's mission is to be the largest and leading life insurance company in the Caribbean.[90] Since it is a wholly owned subsidiary of C L Financial Limited all transactions relating to acquisitions are conducted by the parent group.

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88 From discussion with Mega's CEO it appears that the merger was formalised in 1997 but that informal arrangements had been in place much earlier.

89 Most of the information contained in this section is a summary of discussion with Mega's CEO.

90 Taken from mission statement in Annual Report, 1997.

Table 13
Trinidad and Tobago:
Insurance Industry Market Share
Gross Premium - Ordinary Life (1996-1997)*

Company (position 1997)	1997	1996	Market Share % (1997)	Market Share % (1996)
1. Guardian Life	124.0	82.0	27.0	21.4
2. Clico	57.0	59.0	12.4	15.4
3. ALGICO	47.0	47.0	10.2	12.2
4. Barbados Mutual	46.0	41.0	10.0	10.7
5. Maritime	43.0	42.0	9.3	10.7
6. TATIL	41.0	29.0	8.9	7.6
7. MEGA	22.0	20.0	4.8	5.2
8. BancAssurnace	20.0	11.0	4.3	2.9
9. GTM Life	18.0	15.0	3.9	3.9
10. British American	17.0	14.0	3.7	3.6
11. Life of Barbados	14.0	12.0	3.0	3.1
12. Nationwide	7.0	7.0	1.5	1.8
13. Demerara Life	4.0	5.0	0.9	1.3
Total	**460.0**	**384.0**	**100.0**	**100.0**

Source: Ernst and Young/ATTIC.

* Figures rounded to the nearest million

In 1997, C L Financial acquired 77% interest in the British American Insurance Company Limited's operations throughout the Caribbean and Panama, and 100% interest in the British Fidelity Assurance Limited. Both companies are incorporated in

The Bahamas. C L Financial was experiencing difficulty in setting up offices in the hard currency areas (Bermuda, the Caymans etc) but by these acquisitions it could expand its network with the hope of gaining entry into the American market. This strategy is being pursued because of the relative instability of the regional economies and currencies, especially in the floating regime countries. It is seen as a way of spreading risk and strengthening the organisation. By 1998 it was poised to take over the Florida Insurance Company, worth US$.5 billion, its intention being to focus on the large group of Trinidadians living in the United States, specifically by constructing homes for locals who have migrated to America.[91] In 1997, it made a bold and unexpected move when it acquired Jamaica Mutual's 20% shareholding in Guardian Life for TT$75 million. This raised a lot of ire, especially from allies Royal Bank and Guardian Life, who subsequently sold each other's shares to buyers approved by each company to ensure that CL Financial's interest would not prevail over theirs.[92] The acquisition activities of this company have made it into perhaps one of the largest and most successful conglomerates in the region.

What we have observed about mergers in the insurance sector is that they seem to have been motivated by considerations such as growth and expansion of income and assets, in order to remain competitive; reduction of costs, in order to become more efficient service providers; and expanding into various markets, in order to spread risks and avoid the vagaries of economic cycles that are not likely to occur simultaneously in all locations. They have, therefore, pursued acquisitions not as an end in themselves but as part of an overall strategy aimed not just at survival but also success.

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91 See report in the *Newsday* February 2, 1998 p. 4.

92 Royal Bank sold its 24% stake in Guardian Life and Guardian Life sold 10% of its shares in Royal Bank. If C L Financial had succeeded it would have raised its shareholding in Royal Bank to 28.5%. Royal was averse to this since C L Financial already held substantial interests in another bank. These events were reported in the *Express* November 1, 1997 p, 2.

Commercial Banking

Acquisitions in the commercial banking sector began in the early 1960s when Barclays Bank absorbed the Bank of Trinidad (Gordon Grant) Limited in 1963. That bank was the first local commercial bank established in the Colony. It developed as part of the trading firm of Gordon Grant Limited, and was principally concerned with financing agriculture.[93] By 1969 the Government of Trinidad and Tobago (GOTT) had already proposed the localisation of the banking industry. The then Prime Minister was concerned that the foreign commercial banks appeared not to be supporting local business initiatives. In December 1969 a Swiss banker, Dr. Agathon Aerni, was invited to the country by the Prime Minister with the intention of establishing a local commercial bank by combining the assets of the Trinidad Corperative Bank (TCB) and the Post Office Savings Bank (POSB). At about the same time the owners of the Bank of London and Montreal (BOLAM), Bank of Montreal; Bank of London and South America; and Barclays which operated throughout the Caribbean and Latin America were restructuring their organisation. The local operations were no longer central to their future business activity and hence BOLAM wanted to exit the environment. It may have been coincidental, or perhaps fortuitous, but the Government entered into negotiations to acquire BOLAM's assets. Given the availability of an extant commercial bank, the interest in amalgamating TCB and POSB waned and was no longer pursued. It was government's policy, therefore, which led to the establishment of the National Commercial Bank on June 15, 1970 with authorised capital of TT$15 million but paid up capital of TT$5 million. The assets of the Bank of London and Montreal were acquired on July 1 1970 by the National Commercial Bank (NCB). Thirty-four locals from BOLAM's staff were employed by the new bank, and the ex-

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93 See the History of Banking and Currency in Trinidad and Tobago, Central Bank of Trinidad and Tobago, 1974 p. 42.

patriate Manager remained with the new organisation for approximately six weeks for contingencies.[94]

Following the establishment of NCB in 1970 another indigenous bank, Workers Bank Limited, was established in 1971. The impetus for the establishment of this bank came from the retiring members of the Seamen and Waterfront Workers' Trade Union, who pledged substantial sums for the purchase of shares. The Trinidad and Tobago Labour Congress undertook the role of promoter and GOTT pledged a substantial contribution to the equity of the bank.[95] The bank was established, "out of a social demand and political desire to establish an indigenous bank controlled by workers and their representative organisations as one of the forerunners of an indigenous banking system." [96] Neither of the above institutions was the first indigenous bank to be established, however. That distinction belongs to the Trinidad Cooperative Bank which was established in 1914 by a group of "coloured' merchants and professionals, which had always been critical of the restrictive lending practices of the Colonial Bank and the Royal Bank of Canada (Best and Brown, 1992). The three indigenous banks were merged in 1993, with the successor institution being the First Citizens Bank.

It was probably social pressure and agitation by interest groups that resulted in the establishment of two indigenous commercial banks by 1971 but it was definitely government's policy that led to the localisation of the foreign commercial banks. At the time the transnational banks operating in the country seemed to be serving expatriate interests and lacking in national development objectives. Hence government-owned commercial banks were established in the hope of penetrating the rural economy

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94 This represents a summary of discussions held with Phillip Rochford, former Managing Director and first C.E.O. of NCB.

95 Reported in the Chairman's review of the 1976 *Annual Report* of Workers Bank p.2.

96 *Ibid* p. 2.

and also with the aim of financing the growing public sector activities in the economy. The Government saw the localisation of banks "as a means of ensuring that the policies of these banks were framed in the interest of the local economy."[97] By 1973, three banks; the Royal Bank of Canada, the Bank of Nova Scotia and, Barclays Bank DCO had put significant shareholdings in local hands, while the Canadian Imperial Bank of Commerce (CIBC) incorporated locally in 1980. The American banks First National City Bank (Citibank) and Chase Manhattan Bank resisted attempts at localisation thus forcing the authorities into giving an ultimatum for them to incorporate locally or have restrictions placed on their operations. Citibank agreed but Chase preferred to discontinue its operations (Seepersad, 1995). The assets of Chase Manhattan were acquired by NCB through negotiations. It had operated only two branches, one in Port of Spain and a second in San Fernando. In the late 1970s, the Citibank branches were localised. The name was changed in 1984 to the United Bank of Trinidad and Tobago, with Citicorp retaining a 20% interest. In the 1980s, when government undertook its liberalisation policies Citibank purchased the local shares for approximately TT$25.1 million in 1989.

We mentioned earlier that insurance companies have held significant shareholdings in commercial banks. CLICO appears to be the first such company to have pursued that strategy. By 1984 foreign financial institutions with ownership interest in the local and regional financial sectors began to express concerns about the economic climate which had begun to experience decline; some wanted to divest themselves of Caribbean interests. Given this scenario, CLICO acquired the branch networks of Citibank and Chase Manhattan in Barbados and formed the Caribbean Commercial Bank in 1983/84. In 1986, the Royal Bank of Canada approached CLICO and offered to sell its local branch network to the insurance giant. Profits of its subsidiary, the Royal Bank of Trinidad and Tobago (RBTT) had

97 See, the History of Banking and Currency in Trinidad and Tobago. Central Bank of Trinidad and Tobago p. 46.

fallen precipitously from TT$35.9 million in 1983 to TT$13.1 million by 1986 and provision for bad loans had reached TT$29.6 million in 1987.[98] The Royal Bank was, therefore, no longer interested in retaining its investment in Trinidad and Tobago, where annual growth rates of GDP had been negative since 1983. But the local management raised objections to the sale, making a counter offer of TT$88 million as against CLICO's bid of US$40 million, for the 48% shareholding of Royal Bank.[99] Besides, even though there was agreement between CLICO and Royal Bank, foreign exchange approval was required from the Central Bank. The Government finally ruled that the transaction had to be done on the open market and thus the employees of RBTT, through the Employees Share Ownership Plan (ESOP) were able to acquire 24% of Royal Bank's holdings. The remainder went to the public at large, and hence in 1986 RBTT became 100% local.

In 1988, CLICO was again approached, this time by Barclays Bank PLC, which wanted to divest its 41.18% shareholdings in Republic Bank Trinidad and Tobago Limited (Republic Bank).[100] Presumably because Republic Bank had been realising declining profits Barclays wanted to sell its shares (see Table 14). Republic Bank experienced a drastic decline in after-tax profits, falling from $35.2 million in 1983 to $2.0 million in 1987 (a 94.3% decline) while its provision for bad and doubtful debts increased from $ 38.6 million in 1987 to $54.3 million in 1988. The Republic Bank's shares were trading at $1.06 but CLICO negotiated to purchase the block of 41.18% shares at $2.00 each. The Board of the bank was opposed to the acquisition but since terms were already agreed Barclays suggested that they work out their differences.

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98 Here we are speaking of after tax profits, excluding exceptional items.

99 Reported in the *Trinidad Guardian* July 12, 1986 p. 1.

100 The Bank formally changed its name from Barclays to Republic Bank effective April 1, 1981.

Table 14
Trinidad and Tobago:
Profits After-Tax (1983-1990) TT$ Million* -
Selected Commercial Banks

Year	Royal Bank	Republic Bank	National Commercial Bank	Trinidad** Coopera-tive Bank	Workers Bank
1983	35.9	35.2	5.3	0.2	8.0
1984	35.4	34.2	6.8	-	6.7
1985	24.0	19.1	2.6	(4.4)	4.4
1986	13.1	5.8	6.3	(1.1)	0.02
1987	9.8	2.0	0.7	0.6	3.8
1988	12.7	3.7	1.0	0.5	NA
1989	12.5	7.6	4.0	0.6	NA
1990	13.6	15.3	1.1	2.3	(5.4)

* Profits after tax do not include extraordinary items, and figures have been rounded to the nearest million.

** In 1985 the reporting year end was changed to March 31 and an eighteen month report presented. No report was prepared for 1984.

Source: *Annual Reports* of Commercial Banks.

CLICO agreed to reduce its holdings to 34% but it still required central bank approval to transfer funds out of the country. The Central Bank was unwilling to approve funds at $2.00 per share while stocks were trading at $1.06 and proposed instead that CLICO offer $1.10 per share. The declining profits of all banks, in the mid to late 1980s, owing to low levels of economic activity, resulted in reduced prices of all stocks (see Table 15). Approval was finally given in September, 1989 but by that time Barclays

Bank had agreed to a loan for CLICO to purchase the shares thereby obviating the need to transfer funds, at least in the short term. By November 1989, the shares had not been registered in CLICO's name but when Barclays gave its proxy to CLICO this issue was resolved.

Still, there was further resistance to CLICO. A writ was filed aimed at preventing CLICO from owning shares in the bank, but in the end CLICO prevailed, and its profitability began to soar. The bank began to realise increased profits also, resulting in Republic's share price showing positive growth. All of this redounded to the greater benefit of CLICO which was able to sell 7% of its shareholdings for a sum equivalent to that which it paid to acquire Barclays' 41.18% shareholding.[101]

CLICO through its acquisition of significant interests in Republic Bank had therefore achieved a major objective - the acquisition of banking interests in order to access capital for investment that would promote the development of the region, its main goal. Interestingly, it was never able to, neither did it attempt, to influence the bank's policies.[102]

Merger of Indigenous Banks

Before discussing the merger of the three indigenous banks we believe that it is useful to review the performances of these institutions several years prior to the 1993 merger, since their performances during those years appear to suggest that perhaps such action was warranted much sooner.

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101 The 7% of shares was sold in keeping with its agreement to reduce its holdings to 34%.

102 Much of the discussion on this section represents a summary of an interview with Mr. Peter Salvary, Corporate Secretary, CL Financial Limited.

Table 15
Trinidad and Tobago:
Commercial Banks Share - Issues/Prices
Absolute Prices in TT$

Banks	Year	Issue Price	Mid-Market Quote	Remarks
Royal Bank	April 1973	3.50	6.41	
	January 1978	5.00	11.45	
	February 1987	1.55	1.56	November 23, 1987
Republic Bank	December 1973	2.50	5.77	
	July 1980	7.00	10.35	
	-	-	1.20	November 23, 1987
Bank of Nova Scotia	July 1973	2.00	8.70	
	November 1978	6.20	15.00	
	-	-	3.68	November 23, 1987
Workers Bank	November 1971	1.00	1.20	
	July 1982	4.50	2.49	
	-	-	1.75	November 23, 1987
National Commercial Bank	April 1978	1.80	4.90	
	November 1981	2.75	0.80	
	-	-	0.68	November 23, 1987
Bank of Commerce	May 1980	4.30	12.70	
	July 1982	8.15	1.97	
	-	-	1.80	November 23, 1987

Source: Scotland, Leslie "The Localisation Process in the Banking Industry", in *The Independence Experience* edited by Selwyn Ryan, ISER, 1988 pp. 63-80.

Even though the Trinidad Cooperative Bank (TCB) was the first indigenous bank to be established in the country it did not achieve commercial banking status until March 10, 1976. During the period 1976 to 1987 it had not been a profitable institution. In fact, in 1987 when it recorded a profit of $0.06 million a newspaper report suggested that it was the first time in nine (9) years, except 1983 when it achieved a profit. By then it had been rescued by the Central Bank.[103] The first sign of trouble at TCB appeared in 1984 when its financial statements showed that liabilities exceeded total assets. The bank became a target of business interest, with CLICO expressing an interest in acquiring its assets. However, it was MAT Securities Limited which acquired 62% of the bank's shareholding for TT$6.0 million in 1984.

At the end of the 1984 financial year the bank had reported losses of several million dollars but its auditors, Price Waterhouse, disagreed and suggested that loan loss provision of TT$20 million should have been set aside. Apparently a loan of $20 million was advanced to a related company and its collectibility was in doubt.[104] On February 7 1986 an Act establishing the Deposit Insurance Corporation was passed, and it contained provisions for the Central Bank to intervene in troubled banks. Consequently, on February 21 1986, the Central Bank (The Bank) invoked its powers under Section 44D of the Central Bank Act, allowing it to assume control of TCB, and to pursue action to restructure the bank and also to provide financial assistance. After assuming control, the Bank allied TCB to NCB and appointed NCB's Deputy Managing Director to head the institution. [105] Other senior appointments were made, with the Bank's support and approval, in order to restructure the ailing bank. The Bank intervened in TCB's major shareholder MAT Securities Limited in late 1986.

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103 See story carried in the *Express*, July 16, 1987.

104 Reported in the *Express*, February 25, 1986 p. 3.

105 *Ibid* p. 3.

The fact that MAT Securities Limited was intervened in soon after it acquired TCB suggests that it may have been capital-short and not, therefore, an appropriate institution to acquire TCB which itself was in need of capital. Clearly the acquisition by MAT was ill-advised. It therefore raises questions about the monetary authorities' role in the acquisition process. Did they in fact conduct a thorough investigation into MAT's operations before granting approval for such a substantial ownership interest in TCB?

Following the Bank's intervention in 1986 TCB began to show promise, achieving profits before tax of $1.5 million in 1987 and with improvements recorded between 1987 and 1991. But let us reflect upon TCB's performance between 1975 and 1982, the most prosperous period in the country's recent history. After recording profits averaging $224,000 between 1975 and 1977 with a peak of $260,000 in 1976 it experienced losses between 1978 and 1982, averaging $1.5 million per year, with a peak of $4.2 million in 1981 (see Table 16). In contrast, all other commercial banks in the country were experiencing increasing profits over the period 1975 to 1982 while TCB was making losses (see Table 16). Clearly this fact alone should have triggered some measured response from the Central Bank. But we are not aware of any such action. Perhaps TCB should have been allowed to fail. It was a private institution and it was poorly managed, but it was refloated by the Bank partly with public funds and it continued to under-perform relative to the rest of the industry. Perhaps the authorities feared that the failure of one bank could lead to systemic failure but, given the size of TCB, such fears might have been exaggerated.

In the case of Workers Bank Limited, it realised losses from its inception in 1971 to 1974. However, as the effects of the windfall from the "Oil boom" began to filter down its profitability began to be very robust; it moved from $.05 million profits in 1975 to peak at $17.8 million in 1982. Following the boom, however, its profits began falling and by 1988 it ran into difficulties. The economic climate in Trinidad and Tobago had begun to deteriorate by 1983/84 and a new government, installed in 1986, began to institute very austere measures, some recommended by the multi-lateral financial institutions, in order to restore positive growth.

Table 16
Trinidad and Tobago:
Profits before Tax of the Commercial Banks
(Consolidated) '000 TT$

Year	Workers	% Change	RBTT	% Change	BoCTT	% Change	Republic	% Change
1972	-	-	3,586.5	-	-	-	648.0	-
1973	-220.3	-	7,377.1	105.7	-	-	3,125.0	382.3
1974	-744.4	-237.9	8,117.2	10.0	-	-	5,161.0	65.2
1975	52.8	107.1	9,275.0	14.3	3,819.0	-	6,011.0	16.5
1976	296.3	461.2	14,597.7	57.4	6,067.0	58.9	9,819.0	63.4
1977	960.3	224.1	22,899.2	56.9	8,913.0	46.9	16,942.0	72.5
1978	1,206.2	25.6	29,553.4	29.1	10,098.0	13.3	20,036.0	18.3
1979	1,756.1	45.6	37,720.3	27.6	11,975.0	18.6	29,568.0	47.6
1980	4,722.0	168.9	47,017.6	24.6	17,508.0	46.2	40,506.0	37.0
1981	7,814.0	65.5	59,506.0	26.6	17,671.0	0.9	53,367.0	31.8
1982	17,818.0	128.0	68,705.0	15.5	23,275.0	31.7	65,895.0	23.5
1983	17,445.0	-2.1	80,821.0	17.6	31,582.0	35.7	84,394.0	28.1
1984	15,921.0	-8.7	78,701.0	-2.6	32,145.0	1.8	83,405.0	-1.2
1985	10,620.0	-33.3	49,312.0	-37.3	29,008.0	-9.8	48,875.0	-41.4
1986	10,462.0	-1.5	29,518.0	-40.1	20,899.0	-28.0	21,833.0	-55.3
1987	NA	-	16,100.0	-45.5	13,257.0	-36.6	7,266.0	-66.7

Table 16 - Continued
Trinidad and Tobago:
Profits before Tax of the Commercial Banks
(Consolidated) '000 TT$

Year	TCB	% Change	Scotia	% Change	NCB	% Change	United	% Change
1972	-	-	1,425.0	-	-	-	-	-
1973	-	-	4,599.0	222.7	858.7	-	-	-
1974	-	-	4,820.0	4.8	818.7	4.7	-	-
1975	181.0	-	5,521.0	14.5	1,032.7	26.1	-	-
1976	260.0	43.6	9,199.0	66.6	2,112.0	104.5	-	-
1977	232.7	-10.5	11,116.0	20.8	3,216.6	52.3	-	-
1978	-806.4	446.5	14,372.0	29.3	5,422.8	68.6	-	-
1979	-456.6	43.4	19,685.0	37.0	6,701.9	23.6	5,021.0	-
1980	-	100.0	26,278.0	33.5	4,857.9	-27.5	3,168.0	-36.9
1981	-4,179.1	-	35,628.0	35.6	11,805.0	143.0	3,446.0	8.8
1982	-546.0	86.9	43,591.0	22.4	11,557.0	-2.1	-	-100.0
1983	393.0	172.0	56,619.0	29.9	13,865.0	20.0	4,051.0	-
1984	-	100.0	59,662.0	5.4	13,733.0	-1.0	5,132.0	26.7
1985	-3,552.0	-	54,693.0	-8.3	8,318.0	-39.4	4,817.0	-6.1
1986	-136.0	96.2	42,205.0	-22.8	12,557.0	51.0	4,442.5	-7.8
1987	1,470.0	180.9	N.A.	-	3,450.0	-72.5	1,880.9	-57.7

Source:Leslie Scotland, "The Localisation Process in the Banking Industry", in *The Independence Experience* edited by Selwyn Ryan ISER, 1988, pp. 74-75.

The above probably confirms Farrell's (1988) view that profits masked incompetent management and inappropriate controls, which were revealed as soon as the "boom" ended. In 1988, Workers Bank began to depend on the Central Bank to either fund or waive its reserve requirements and to provide liquidity support. In the last quarter of 1988 a model was derived to restructure the failing Workers Bank, which was by then insolvent.[106] It had accumulated over $100 million in receivables from interest income stretching back several years. Workers Bank, because it entered banking late, had introduced a product "The Varin-Stall plan" aimed at giving them a competitive edge. Initially it worked, but when the economy went into decline, many of its clients, who were public servants, and therefore those most severely affected, were unable to repay their debts.[107]

Between 1983 and 1986 Workers Bank after-tax profits declined from TT$8.0 million to TT$0.02 million while the bank's loan portfolio decreased from TT$ 332.5 million to TT$247.9 million over the same period (see Table 17). Given that the bank's main source of income (its loans) was declining it is not surprising that its profits were low. But it was faced with another problem, non-repayment of advances, one which threatened the foundation of the bank itself. Ryan (1992) writes:

> *"The Workers Bank collapsed in 1988 and had to close its doors to prevent a run on its holdings. Many directors also authorised unsecured loans to themselves and their friends for housing and other projects that lacked transparency. Often this was*

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[106] In an address to a Port of Spain Rotary Club on August 15 1989, the bank's new General Manager suggested that by December 31 1988 it was technically insolvent.

[107] When the economy went into decline public servants were more affected than private sector workers. In fact there were no public sector wage increases between 1982 and 1993. Moreover, public servants were subjected to salary cuts in 1988 (10%) with annual performance increments suspended indefinitely.

done in conjunction with trade unions officials who were members of the Board or politicians who had formal links to the Directorate of the bank... People borrowed from the bank but did not bank with it."

Table 17 also reveals that NCB's loan portfolio, though significantly greater than that of Workers Bank, was perhaps of lower quality, given the relatively lower returns.

Table 17
Trinidad and Tobago:
After Tax Profits and Loans Portfolio (less provisions)
TT$million - Selected Commercial Banks (1983-1987)

	Workers Bank			NCB	
	Loans Portfolio (Less Provision)	**Profits After Tax**	**Year**	**Loans Portfolio (Less Provision)**	**Profits After Tax**
	332.5	8.0	1983	922.1	5.3
	296.4	6.7	1984	885.9	6.8
	249.6	4.4	1985	929.1	2.6
	247.9	0.02	1986	920.4	6.3
	247.7	3.8	1987	970.9	0.7
Average	274.8	4.6		925.7	4.3

Source: *Annual Reports* of Commercial Banks.

Given the above scenario at Workers Bank and the problems which were by 1986 deep-seated, it was very strange that the bank's Chairman in the 1986 Annual Report could refer to its spectacular growth in assets and shareholder's equity which, even though they might have been significant, were overshadowed by the poor operating performance. Yet nothing about that was mentioned. It might therefore have been a combination of poor management and lax supervision by the authorities which led to the bank's failure. Perhaps another explanation for the bank's failure lies in the pattern of its lending. As early as 1982 when it was enjoying good profitability two opposition Members of Parliament had raised concerns that Workers Bank was becoming too "Commercial" and ignoring its earlier "developmental roots."[108] The bank concentrated all of its lending activities on mortgages, real estate and property development loans and virtually ignored the consumer credit market.[109]

By December1988, the bank was technically insolvent. It was unable to meet its liquidity requirements and it assets were of poor quality, causing a serious erosion of its capital.[110] Between January and February 1989, the Inspector of Banks conducted a special examination from which he concluded that the bank was technically insolvent. In March, the Chairman of the bank requested financial support from the Central Bank, because of a shortfall in its income. Assistance was not provided immediately but the Bank requested that a special investigator determine the extent of the institution's financial needs. During that period, rumours started that the bank was insolvent leading to a partial run on the institution. The Central Bank intervened to avert a full scale run and suspended operations for thirty days, on April

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[108] Reported in the *Express*, May 27, 1982 p. 13.

[109] Reported in Managing Director's Review of the 1990 *Annual Report of Workers Bank* (1989) Limited p. 5.

[110] See story in the *Express*, August 20 1990 p. 5.

18 1989.[111] Within two weeks of this incident, depositors began withdrawing funds from NCB causing that bank to reassure customers that it was safe. During the ten-day period that the run lasted about TT$100 million was withdrawn by depositors (Nelson, 1995 p. 181).

Before the thirty-day suspension expired, the assets and liabilities of the bank and those of its subsidiary trust company were vested in Workers Bank (1989) Limited. It was formed with the intention of rescuing the Workers Bank of Trinidad and Tobago Limited (the old bank) and protecting its depositors and creditors, and it operated under the control of the Central Bank Act, Chapter 79:02, as amended. A company, Taurus Services Limited, was established in May 1989 with authorised share capital of 50,000 to purchase the non-performing loans of the old bank in consideration for the issue of a note to be guaranteed by the GOTT.[112] Taurus was given the responsibility to collect and restructure the loans in its portfolio.

In the restructuring process, fourteen executives were fired and new management brought in to run the bank. Two senior bankers from Royal Bank and one from Republic Bank were seconded from their organisations to assist the newly appointed Managing Director of the Workers Bank (1989) Limited. The capital for the new bank was sourced from the GOTT, the National Insurance Board, Commercial Banks and Credit Unions. Initially, it received certain concessions; for example, it was not required to fund its reserve requirements. It realised a loss after its first year of operations but rebounded and recorded reasonable profitability until the merger took place.

It appears that the GOTT was provided with an excellent opportunity in 1989 to merge both TCB and the Workers Bank.

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[111] An *Express* reporter, in a story carried on August 20 1990, claimed that TT$ 65 million was withdrawn in two days. p. 5.

[112] The *Express* of April 28, 1989 reported that the bank had non-performing loans of TT$46 million, while its Trust Company carried a non-performing portfolio of TT$145 million.

They were in control of TCB and had to take corrective action at Workers Bank in 1989. For one thing the new management at TCB appeared to have turned around the bank and therefore they might have welcomed an opportunity to handle additional responsibility. Both banks were small and merger at that time would have provided a good platform for success. Instead they were run separately, perhaps with insufficient capital and other resources, and hence public confidence in those institutions was low relative to the other banks.

The merger of the three indigenous banks became a critical issue because the fundamental elements of NCB's weaknesses were beginning to become evident to the market. A failed attempt to sell interest in its Merchant Bank was perhaps a reflection of the market's recognition of NCB problems and weaknesses. It was against the background of the potential failure of perhaps the third largest bank in the country that consideration was given to a merger of the three banks.

In the case of NCB, however, its after tax profits were declining in the face of an expanding loans portfolio. Perhaps two factors can explain this anomaly, one being the relative inefficiency of its operations and the other its inability to collect loans resulting in a huge underperforming portfolio.[113] The National Commercial Bank (NCB) was the largest of the three banks which merged in 1993. It was generally perceived to be an "African bank," its management being largely of "Afro-Trinidadian stock" and there was the notion that the Government had established it to provide resources to the so-called "small man."[114] Like most

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113 Nelson (1995) refers to a report by the Inspector of Banks which suggested that the deterioration of NCB's loan portfolio was partly due to certain deficiencies in credit administration.

114 It is interesting to note that all commercial banks in the country were perceived in ethnic terms: Scotia Bank as the Chinese bank; Republic and Royal as the Caucasian banks, and Bank of Commerce as the Syrian and Indian bank. The most recent commercial bank, Intercommercial Bank is perceived as a bank for the Indians, something which has been touted by a group representing Hindus.

commercial banks, NCB enjoyed good profitability during the period of the "oil boom." In 1973, three years after it began operations, it posted profits of TT$0.9 million while Workers Bank, which was established one year after NCB, realised a TT$0.02 million loss. NCB's profitability peaked in 1983 at TT$13.9 million, though in between 1973 and 1983 there were periods when profitability declined, although remaining positive. By 1983, Workers Bank had become a more profitable institution than NCB (see Table 17).

During the period 1983 to 1987 there was considerable fluctuation of the level of profits (see Tables 16 and 17). In 1987, NCB's profits after-tax reached a low of TT$0.7 million partly on account of a severance programme which cost $2.0 million and an initial contribution to the DIC amounting to $5.1 million. Interestingly, while virtually all of the banks evidenced significant decline in their profit positions between 1983 and 1986 (see Tables 16 and 17) NCB's position changed only marginally. In percentage terms, NCB's position declined by 7.6% in 1986 when compared to 1983. For all other banks the comparative changes were much more significant for the immediate post "oil boom" period: Scotia's profits declined by 25%; Royal's - 63%; Republic's - 74%; BOC's - 34%; Workers' - 40%, with TCB the only bank realising losses.

In virtually all cases 1987 was the worst year for commercial banks, in terms of profitability in the post "oil boom" period but they rebounded in 1988 and made considerable gains by 1992 (see Table 18). Comparing commercial banks' net income in 1987 with their returns in 1992 it is clear that NCB's performance was way below most banks. NCB's net income increased by 47% while the other banks, except Scotia and Workers, all recorded more significant improvements. In the case of Scotia Bank, that institution showed very little variation in profitability. With respect to Workers bank, 1987 was the last year before it failed so that the comparison is not totally appropriate. When we compare the banks' performance using net income to total revenue ratios for the years 1987 and 1992 (see Table 18) it is obvious that NCB is the worst of the lot. It is interesting to note that the Bank of Commerce, whose total

revenue was lower than NCB's in both periods, recorded higher net incomes.[115] This is clearly an indication that NCB's operating performance was poor in relation to the others. The operating costs ratios in (Table 25) confirm that NCB's performance was worse than the other commercial banks. Its ratio of total expenses to total assets increased from 11.64% in 1986 to 12.26% in 1992 while those of most other banks declined over the same period.

Table 18
Trinidad and Tobago:
Commercial Banks % Change in Net Income;
(1983 & 1986), (1987 & 1992) -
Ratios of Net Income to Total Revenue (1987 and 1992)

Commercial Banks	Net Income 1983, 1986 % Decrease	Net Income 1987, 1992 % Increase	Net Income/ Total Revenue 1987	Net Income/ Total Revenue 1992
NCB	7.2	47.0	1.0	1.4
Royal	63.4	170.0	4.0	8.4
Scotia	25.4	16.0	9.1	6.6
Republic	74.1	2050.0	1.1	11.0
Bank of Commerce	33.9	150.0	4.4	10.2
Workers	40.2	(29.0)	8.6	4.1
Trinidad Cooperative*	(134.6)	266.0	2.5	4.3

* TCB recorded a loss in 1986.

Source: Computed from Tables 16 and 17.

115 Of the five large banks excluding workers and TCB, Bank of Commerce was considered to be the smallest.

What our review of the three banks, NCB, TCB and Workers Bank reveals is that two of the banks had virtually collapsed while the third was struggling to remain profitable. Perhaps none of them could have survived without government support. Certain factors may have worked against the three banks, however. While the ratio analysis clearly shows their relative inefficiency, they were perhaps always facing an uphill battle. First, to be accepted as legitimate banks and second, to compete effectively with the more established banks. In terms of the historical connections, most of the well established businesses were loyal and longstanding clients of the other banks. A significant portion of income came from foreign exchange transactions for merchants and distributors, and the indigenous bank, at the time, were able to capture only a small percentage of this market. In addition, because they were relatively new, NCB, TCB and Workers Bank bid up the interest rate in order to attract deposits, often to their detriment. Those actions contributed to extremely high operating costs and partly explains their relative inefficiency. We now turn to an examination of the merger itself and we shall attempt to determine whether it was successful.

What are the factors which led to the merger of the three banks? In 1991, the National Commercial Bank initiated a process aimed at divesting equity in its subsidiary, the International Industrial Merchant Bank of Trinidad and Tobago. At that time, the bulk of NCB's profits was derived from its subsidiaries, not the commercial bank, and the merchant bank was touted to be "the jewel" in its crown. Initial success was achieved when 14% of the equity was sold for TT$ 11.9 million. However, when an evaluation of the institution was undertaken it was recognised that the merchant bank had problems. The potential failure of such a large bank could impair public confidence and possibly lead to crisis. Something had to be done to arrest this situation. It was perhaps this reality which led to merger discussion among the three banks: NCB, Workers Bank, and TCB. It is instructive to note that it was the commercial banks which approached the Central Bank, in 1992, with the idea of merger rather than the other way around.

By 1991 all three institutions had experienced difficulties and two continued to rely on the Treasury for support. They were underperforming compared to the rest of the industry, in terms of profitability and efficiency.[116] In the case of profitability, Table 18 shows that whilst most banks achieved increases of over 100%, if 1987 is compared to 1992, (1987 being the least profitable year for banks in the post boom period, and 1992 a year when profitability was on the rise) NCB and Workers Bank did not compare favourably. The Trinidad Cooperative Bank was refloated in 1986 and hence no comparison with it should made since it was provided with substantial assistance. As for Scotia Bank, its profits have been very consistent. It probably was the most stable bank throughout the lean times. Scotia's success was perhaps due to its lending focus, it being the leading bank in consumer financing. The other banks were engaged to a larger degree in financing business activity which was at the time very flat and hence they encountered repayment problems by clients, and realised lower profitability. In terms of a comparison of the percentage of total revenue retained as net income in 1987, as against 1992, the performance of the other banks is far superior to NCB, Workers Bank and TCB.

When we compare after- tax profits and earnings per stock in 1992 (Table 19) the three banks trailed their rivals again. Another interesting statistic is revealed in Table 19; BOC with fewer assets than NCB in 1992, achieved profits four and a half times greater than that institution, perhaps an indication of the better use of resources by BOC. With respect to efficiency it should be noted that in 1992 most banks did not disaggregate expenses and hence for the study we were confined to measuring total expenses against total revenue. It was possible to measure operating expenses against total income for only three banks. In general, the cost ratios of all banks were high, regardless of the measure used. However, in 1992, among all banks, NCB, Workers Bank and TCB displayed lower efficiency levels,

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116 Nelson (1995) asserts that the dominant view was that managerial incompetence was chiefly to blame for the weak performance of indigenous banks.

Table 19
Trinidad and Tobago:
Commercial Banks: Financial Statistics (1992)
TT$ Million

Banks	Total Assets	After Tax Profits	Earnings Per Stock (Cents)	Ratio of Total Expenses to Total Revenue %	Ratio of Operating Expenses to Total Income* %
Republic Bank	3040.0	28.5	0.37	85.3	77.8
Royal Bank	2788.2	27.4	0.48	86.3	77.0
Scotia Bank	1767.0	13.8	0.54	87.6	N/A
National Commercial Bank	1441.1	2.6	0.08	98.5	N/A
Bank of Commerce	1383.4	11.6	0.37	85.1	N/A
Workers Bank	1093.7	3.3	-	95.9	89.3
Trinidad Cooperative Bank	516.9	2.3	-	92.9	N/A

Source: *Annual Reports* of Commercial Banks (several issues).

*Because of reporting style, ratios could not be calculated for all banks.
Total Income = Total Revenue - Interest Expense
Total Expenses = Operating Expenses + provision for loan losses.

averaging 95.7% of total expenses to total revenue, as against 86.1% for the other banks and 90.2% for the industry as a whole. Of course, these statistics suggest that none of the institutions was efficient but the three banks were clearly worse off. By way of comparison, Macy and Miller (1998) have reported cost to income ratios of less than 60% for US banks; less than 74% for German banks; less than 65% for Japanese banks and; less than 72% for Swiss banks.

But why were those three banks underperforming the rest of the industry? There are several perceptions that held wide currency:

i) The majority of managerial staff at those banks were not career bankers but academically trained persons who were not schooled in banking;[117]

ii) The other banks, because they evolved from organisations which ensured that established procedures and policies were followed, were better able to navigate difficult circumstances because of experience and know-how which were lacking in the three banks;

iii) Individuals would deposit their funds in the other banks, which they considered safe, but borrow from the three banks which they considered weak. Those banks, therefore, paid premium rates to attract deposits thereby increasing their funding costs;

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117 It is interesting that while this perception was widely held, in fact about half of NCB's managers had been elevated to those positions after several years of routine work. Perhaps in the early years none of its competitors' managers had academic qualifications and perhaps the disparaging comments were made for competitive reasons. Throughout the 1960s most bankers did not have post- secondary education, they were "qualified by experience."

iv) It was widely touted that friends of officers and directors of two of the banks could access loans without collateral and that record-keeping was atrocious. Those banks also did not pursue aggressive collections' policies and this led to huge unhealthy portfolios.

About the latter, Ryan (1992) writes " *Workers Bank, Coop Bank and NCB were said to have been much too lenient and indulgent with debtors ... One bank, the NCB, had to set aside as much as $80 million to cover losses ... strong criticisms were in fact later leveled at NCB and Workers Bank by external auditors and the Inspector of Banks for their indulgence towards certain businessmen who had substantial non-performing loans which had not been called.*" The Governor of the Central Bank of Trinidad and Tobago is reported to have said, in 1993, that following their decision to take control of Workers Bank in 1989, there were large withdrawals from TCB and NCB and therefore fear that the banking system would be disrupted. The Bank had to provide substantial liquidity support to both. The deposit base of TCB was concentrated on a few large corporate accounts which, in the event that a deposit left the bank, could encounter difficulties meeting liabilities.[118]

We find it very curious that the Central Bank did not intervene with a view to merging the three banks prior to 1993, especially given the poor performances in profitability and efficiency between 1983 and 1992. Two of the banks were already under their control and the third, perhaps the weakest by 1992, was experiencing difficulties. It may be that under the old Financial Institutions Act (FIA) there was some ambiguity about the timing of intervention. Fortunately, in the revised FIA (1993), specific requirements are in place that would trigger action by the Bank. In addition, we understand that an "exit policy" is being considered for troubled financial institutions. In our opinion, however, governments in the region appear extremely reluctant to close financial institutions even when such action might have

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118 See *Trinidad Guardian*, November 11, 1993 p.1.

been recommended by regulators. Perhaps it is not a politically correct action for a government to take since it is likely to impact mainly small savers whom the governments rely upon to retain political power.

The Central Bank having been approached by the commercial banks for assistance set up a Merger Committee in July, 1992. In January, 1993 the Committee recommended:

i) that NCB should acquire Workers Bank and TCB on the basis of average stock market prices for the month up to January 7, 1993 and;

ii) that the Central Bank and the Government provide substantial financial support but that such support should not exceed 20% of the equity.

The Board of TCB accepted the report but it was rejected by both NCB and Workers Bank, as well as the Minister of Finance and the Central Bank.[119] The Bank responded by contracting Ernst and Young (UK) to conduct an objective due diligence exercise of the three banks, and a valuation of shares.[120] The exercise showed that capital was severely eroded and that ordinary shareholders stood to lose in a merger. They concluded that NCB's shares were worth between 0.05¢ and 0.10¢ per share. At the time NCB's share was trading at 0.79¢ while TCB's was trading at $2.00.[121]

The Ernst and Young report was leaked to the press, and a newspaper report on September 09, 1993 suggested that there might be a run on the three banks when they opened for business

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119 *Ibid.* p. 1.

120 A 1993 Price Waterhouse audit had given TCB a book value of $3.50 per share but Ernst and Young's audit suggested negative net worth. Reported in the *Newsday* October 19, 1993 p. 13.

121 Reported in the *Trinidad Guardian* November, 25 1993 p. 4.

on Monday September 13, 1993. Perhaps the Government chose not to exercise its option to close the banks since such action would have placed heavy demands on the DIC and the Government would have had to finance the relief payments. But it was more concerned that a run on any bank could lead to a worse problem, that of systemic failure, as occurred in neighbouring Venezuela earlier in the year. It therefore moved swiftly to suspend trading in both NCB's and TCB's shares and merged the three banks on September 12, 1993.[122] This action was necessary to avert a possible crisis. The Bank then extended a deadline to shareholders of both NCB and TCB to take up an offer to redeem their shares at 0.10¢ and $1.00 respectively. Several shareholders , dissatisfied with the offer made to them, initiated legal action against the Bank which action is still before the courts.

In support of its decision to merge the banks and to establish the First Citizens Bank (FCB) in 1993, the Governor of the Central Bank of Trinidad and Tobago was reported to have said:

> *"I was fearful that if no immediate action was taken there might have been a run on the three banks when they opened for business on Monday, September 13, 1993. The Central Bank was of the opinion that the interests of the Trinidad Cooperative Bank's depositors and creditors were threatened, that TCB was likely to become unable to meet its obligations and consequently that the financial system of Trinidad and Tobago was in danger of disruption, substantial damage, injury or impairment. The Bank, therefore, intervened to forestall the actualisation of these threats."*[123]

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122 It should be noted, however, that the First Citizens Bank Limited was incorporated in March 1993 with the intent of acquiring the assets of the three banks,

123 Reported in the *Express*, November 9, 1993 p. 3.

Given the prevailing circumstances and the anxiety over safety of deposits which would have been uppermost in customers' minds, the action of the authorities could scarcely be faulted.

Following the merger a memo of understanding between the Central Bank and the First Citizens Bank imposed certain reporting requirements on the new bank. It was required to submit to the Bank, its strategic plans, its budgets, and monthly, quarterly and semi-annual financial statements. The new bank was placed under close scrutiny but there was a good deal of "intimacy" between the Central Bank and FCB. Initially a monthly report was forwarded to the Board of the Bank but we are uncertain if this continues. No cash was given to the new bank but notes guaranteed by the Government were placed on its books. The institution would be entitled to cash at the maturity of bonds but interest payments would be made in the interim. Additionally, an investor could reduce notes by buying equity in place of government ownership.[124]

The combined assets of the three merged banks, using 1992 figures, placed FCB with TT$3.05 billion, in the same asset size category as Republic Bank and Royal Bank with TT$3.04 billion and TT$2.79 billion respectively (see Table 20). The assets of the new bank comprised TT$776.6 million notes receivable and a TT$350 million long-term note from the Central Bank. Included in the loan notes receivable were:

i) a note for $678.6 million from Taurus Services Limited for assets (non-performing loans) sold to Taurus, whose principal and interest have been guaranteed by the Government;

124 There has been a lot of speculation that FCB would be divested to a foreign bank and more recently Royal Bank of Trinidad and Tobago expressed an interest in acquiring its assets. But there has been no official word on its likely future.

Table 20
Trinidad and Tobago:
Commercial Banks - Assets (1985-1998)
(unconsolidated figures $000s)

Year	BOC	FCB	NCB	Republic	Royal	Scotia	TCB	Workers
1985	1,029,298	-	1,560,728	2,430,881	2,194,330	1,343,757	146,666	NA
1986	1,028,573	-	1,383,192	2,331,459	2,173,114	1,439,859	143,975	NA
1987	1,031,281	-	1,399,243	2,290,327	2,131,087	1,510,853	215,798	NA
1988	1,059,878	-	1,390,149	2,309,680	2,188,340	1,607,659	227,710	NA
1989	986,628	-	1,294,091	2,443,228	2,309,561	1,580,331	238,334	953,968
1990	1,141,026	-	1,368,846	2,644,103	2,397,359	1,563,369	278,111	1,101,786
1991	1,283,905	-	1303,563	3,089,262	2,773,463	1,767,137	368,204	1,093,665
1992	1,383,381	-	1,441,126	3,040,040	2,788,246	1,767,625	516,933	-
1993	1,471,115	-	-	3,660,712	3,537,163	2,079,052	-	-
1994	1,636,119	3,203,349	-	3,994,035	4,124,098	2,533,115	-	-
1995	1,977,872	3,225,184	-	5,274,160	4,993,047	2,906,828	-	-
1996	-	3,170,983	-	6,301,707	N.A.*	3,303,207	-	-
1997	-	3,593,069	-	6,924,697	6,278,001	4,068,767	-	-
1998	-	4,016,900	-	8,018,582	7,528,247	4,917,751	-	-

Source: *Annual Reports* (Various Years).
* Royal Bank's year end was changed from September 30 annually to March 31 annually hence no report available with 1996 data.

ii) a note for $98 million issued by FCB Holdings Limited as consideration for $40 million in redeemable preference shares in FCB Limited (the bank), and a non-interest bearing note of $58.0 million issued by FCB Limited. The Government has guaranteed both instruments.

The long-term note comprises GOTT commercial paper received from the Central Bank in consideration for loans totalling $137.0 million and fully paid-up ordinary shares of $213.0 million acquired by FCB Holdings Limited. By 1998, accumulated interest payments of $93.1 million were yet to be received from the Government.

The new bank, in its initial business plan prepared in December 1993, identified its strengths as: the size of its network, 31 branches; its customer base, which it claimed has proven to be loyal; its staff and management, which it believes were among the best trained in the industry; its size, the critical mass it attained with the merger; and its technology, inherited from Workers Bank, which was better or at least on par with the industry's best. All of the above, it believed, would allow it to successfully compete, and to provide its clients with improved services. It identified threats in the areas of a sluggish economy, competitive market issues, and staff acculturation issues.

It identified its performance objectives and strategy as revolving around an emphasis on quality which it hoped to achieve by creating and promoting a new corporate image, one based on Total Quality Management. It suggested that its most critical objectives, within the first three years, would be cost control and improvement in asset yields, though it recognised that deposit costs would be higher than industry levels, and asset yields lower.[125] In the area of deposits, the merged bank controlled 21%

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125 Because it was a new bank it would have to offer more attractive rates to win new business or even to retain old business.

market share but 30.35% of the interest expense, owing to the high concentration of fixed and call deposits. In the area of loans, FCB's market share was identified as 19%, compared to Republic's 24% and Royal's 21%. It proposed that new loans be managed with such control that provision not exceed 0.75 of 1.0%. It therefore made the following projections to 1996:

i) to increase profitability from 0.16% of average assets in 1994 to 0.49% by 1996;

ii) to increase asset growth by 7% between 1994 and 1996, with market growth of 6%;

iii) to increase deposit growth by 10% between 1994 and 1996, with market growth of 9%;

iv) to increase its capital strength by 10%, and to raise its capital to total assets ratio to 8.6% over the period.

It proposed to achieve its goals by developing new products; delivering services effectively, establishing high standards, improving staff resources, improving its risk management and collection techniques, and by continuous monitoring and measuring of services. In addition, it intended to rationalise and upgrade its branch network.

We now review the period 1994 to 1998 to determine whether the bank achieved the projections made in its initial business plan following the merger (see Table 21). In the area of profits as a percentage of average total assets, the target of 0.49% was exceeded by the end of 1996 and reached 1.0% by 1998. With respect to asset growth, the target of 7% was not achieved until 1997 when growth of 13.3% was recorded. It averaged 12.5% between 1997 and 1998. With regard to deposit growth, the target of 10% was achieved by 1995 but there was a decline in 1996, before it rebounded to achieve average growth of 13.2% between 1997 and 1998, with a peak of 32.5% in 1998. These results are probably a reflection of the growing confidence which individuals began to place in the institution once its profitability started to

grow. In the area of capital adequacy, the target of 8.6% was exceeded by the end of 1995, and has averaged 10.5% between 1995 and 1998. If we use the above guidelines alone to measure the bank's performance, then we have to conclude that the merger has been a success.

Table 21
First Citizens Bank -
Financial Statistics (1994-1998)

Year	Asset Growth (%)	Deposit Growth (%)	Capital to Total Assets Ratio	Profits as % of Average Total Assets	Pro-vision for New Loans (%)
1994	-	-	10.6	-	-
1995**	0.67	10.8	10.3	0.30	-
1996	(1.68)	(4.5)	11.0	0.52	4.0
1997	13.3	13.9	10.4	0.88	6.2
1998	11.8	32.5	10.5	1.0	0.54
(Target % Growth 1996)	7.0	10.0	8.6	0.49	0.75

Source: Computed from Financial Statistics in *Annual Reports* (several years).

* * In the case of 1995 alone profits before tax was used. In all other years profits after tax used. At 1995 year end the bank posted a before tax profit of $9.6 million but an exceptional item of $24.7 million (comprising restructuring costs associated with termination and severance benefits, as well as payments to the DIC and provision for bank closures) resulted in an after tax-loss of $ 13.3 million.

But let us examine some other statistics. At the time of the merger FCB's asset size was similar to that of both Republic and Royal but greater than ScotiaBank. By 1998, it was the smallest of all the banks which existed in 1993 (See Table 20). Its market share of loans and deposits was19% and 21% respectively; these have moved to 22.2% and 16.4%. Though it has shown considerable improvement in its profitability, it occupies the cellar position among the banks (see Table 22). Notwithstanding this, its progress has been good and if it continues in this vein its results can only improve. In terms of its operating efficiency, it appears to have made substantial progress (see Table 23). The one area in which there is cause for concern is in the loans category. In its initial business plan it recognised the need to be more vigilant and cautious with advances, and proposed that provisions for new loans not exceed 0.75%; unfortunately it started badly with provisions averaging 5.1% between 1996 and 1997. To its credit, however, in 1998 these have been restricted to 0.54%.

In summary, we believe that the merger has proved to be successful, and that the decision by the Government to intervene in 1993 has been validated. Certainly this is a shot in the arm of the authorities even though they can be accused of having allowed the situation to deteriorate by not taking action earlier. However, the Government has to keep its part of the bargain and forward the outstanding interest payments to FCB in order that it might improve its cash flow. Given that the merger was undertaken to ensure the stability of the financial system, its success ought to be judged also by whether this was achieved. Initially, public reaction appeared to be somewhat sceptical. People seemed to be playing a "wait and see" game before committing fully to the new bank. Thankfully, with the passage of time confidence in the institution has grown. The growth is due in part to its improving profitability record and its greatly enhanced public image. We therefore believe that from a public policy view-point, the merger has been successful, and that the costs involved, though substantial, have been fully justified. Perhaps this issue is more important and central, though the questions about efficiency are not unimportant.

Table 22
Trinidad and Tobago:
Commercial Banks - Net Income (After-Tax) $000s
(1985-1998)

Year	Commerce	FCB	NCB	Republic	Royal	Scotia	TCB	Workers
1985	11,187	-	2,553	19,066	24,951	21,496	(5,199)	N.A.
1986	7,759	-	6,280	5,813	22,100	15,981	(1,057)	N.A.
1987	4,142	-	733	1,972	9,810	13,803	611	N.A.
1988	6,827	-	1,024	3,658	15,840	15,993	539	N.A.
1989	7,732	-	4,042	7,559	12,512	17,107	1,140	N.A.
1990	10,733	-	1,791	15,252	13,646	16,860	2,294	(5,412)
1991	12,730	-	2,339	26,318	19,115	18,552	13,740*	489
1992	11,622	-	2,598	28,534	27,448	13,787	2,253	3,315
1993	9,448	-	-	71,077	36,854	22,161	-	-
1994	13,650	1,891	-	62,391	61,467	35,853	-	-
1995	22,299	(13,343)	-	106,591	84,548	42,506	-	-
1996	-	16,566	-	128,534	N.A.	56,126	-	-
1997	-	29,769	-	159,293	129,862	75,500	-	-
1998	-	39,819	-	197,541	191,296	93,245	-	-

Source: *Annual Reports* (Various Years).
* Includes an exceptional item (sale of property)

The Republic Bank/Bank of Commerce Merger

Perhaps the most interesting merger to have occurred in the regional financial sector was that between Republic Bank Limited and the Bank of Commerce (BOC). It was interesting from the standpoint of the many attempts at either resisting or obstructing the merger by elements opposed to Republic's takeover bid. The formal offer to acquire CIBC's 48.4% shareholding in BOC was made in December 1993, but the legal merger was not completed until October 1997. During this period there was much manoeuvering and uncertainty as to the final outcome as various agents attempted to either retain or gain a competitive advantage.

In August 1993 the Republic Bank Limited disclosed its intention to acquire the Bank of Commerce. The Chairman of the Republic Bank suggested in its 1993 *Annual Report* that globalisation placed increasing demands on business enterprises, especially those in small developing countries, and that his organisation's strategy for dealing with globalisation was the attainment of optimum size in order to compete effectively. Prior to the creation of FCB, Republic was the definite leader among local banks, in terms of asset size, but after the merger it was recognised that the combined assets of the merged institutions would place them on almost even terms. Perhaps it was this consideration that influenced Republic to target BOC which, by virtue of the FCB merger, became the smallest bank. Perhaps fortuitously, at about the same time, a senior executive from BOC who had spent several years with CIBC in Canada, was preparing a proposal, "Project New World," that would chart CIBC's future activities in the Caribbean. It appears that CIBC and Republic found common cause. CIBC was paying little attention to BOC's technological needs, and being aware of the huge costs involved in updating the institution's operating system, it was happy to work out a deal. Republic, on the other hand, was anxious to expand both locally and regionally. A deal was hammered out that would result in Republic acquiring CIBC's 48.4% shareholding of BOC and 20% shareholding of CIBC West Indies Holdings Limited, a company recently (1993) incorporated in Barbados to manage CIBC's banking interests in the

Caribbean. CIBC would gain 20% of Republic's shares in exchange for assets surrendered to Republic. Presumably, the latter saw the acquisition as an opportunity to maintain its leadership in the local market, and also to expand into a new market as the affiliate of a strong international bank.

Following the initial announcement by Republic a meeting was arranged by BOC managers, who were anxious to understand the implications of the transaction and the likely impact upon them. After the first meeting another was called within a short time frame. Anxiety levels had begun to rise not only among managerial staff but also among subordinate staff, whose concerns and fears could not be allayed by the managers. By the second meeting a small group of managers had established contact with a Boston bank to explore the possibility of challenging any proposed bid. However, this idea did not receive wide support. Instead, a letter signed by all managers present at that meeting was dispatched to the Chairman and Chief Executive Officer of CIBC outlining concerns and fears and asking for clarification of their intentions. A response was quickly dispatched from CIBC, with managers receiving separate letters which sought to allay fears by indicating that CIBC was committed to its investment in BOC. While this action might have lessened fears they were never totally removed. Between the initial announcement and the formal offer, staff were asked to avoid discussion and not to offer opinions about the merger with clients but to focus on providing quality service to customers and to be productive so as to ensure that the bank remained successful.

At the time of Republic's disclosure of interest in purchasing the Bank of Commerce, the former's share price was $5.36 while the latter's stock traded at $3.80. When the official offer was made, the stock prices had increased by 8.0% and 10.5% respectively. The initial announcement by Republic triggered action by its rivals who were eager to block the merger, which in their view would provide Republic with a competitive advantage. There were suggestions that both Royal Bank and Citibank had held

talks with CIBC about acquiring its shareholding.[126] In fact, Royal Bank began purchasing BOC shares in August and by December, 1993 it had acquired a 20.4% shareholding, 10% of which was purchased at $4.90 per share (see Table 23).[127] CIBC subsequently indicated that it was unwilling to sell to anyone but Republic and that it viewed Royal's interest as inappropriate and unwelcome.[128]

An accommodation among Republic Bank, Interamerica Trading Company and a private individual allowed Republic Bank to gain controlling interest in BOC.[129] Republic purchased 23% of the shares for TT$80 million; Interamerica, 18.5% at $34.5 million and the other party 6.9% and $12.9 million, all purchased at $4.57 per stock, 10% greater than the previous day's closing price. Had Republic purchased more than 25% it would have needed to obtain Central Bank approval. Following the purchase of CIBC's 48.4% shareholding, an Extraordinary General Meeting of Republic Bank's shareholders was called in January, 1994 at which it proposed to offer shareholders of BOC two Republic shares for every three BOC shares held, in an effort to acquire the remaining shares as a basis for merging the two banks. The proposal was withdrawn as it did not receive the approval of Republic's shareholders. It was defeated by a margin of votes (51.7% versus 48.3%) largely on account of CLICO's initiatives.[130]

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126 See report in the *Express*, September 21, 1993, p.1.

127 BOC shares reached a peak of $4.90 at November 19, 1993 but had declined to $4.20 by December 14, 1993.

128 Reported in the *Express*, May 16, 1994, p. 19.

129 Interamerica Trading Company is incorporated in Barbados and is responsible for Suzuki sales in the Caribbean, Mexico, Central America and Brazil.

130 CLICO, the majority shareholder of the bank with 34% of shares perhaps believed that the management's aim was to dilute its influence; they, together with allies, defeated the bank's motion.

Table 23
Trinidad and Tobago:
Closing Prices of Commercial Bank Stocks (TT$ Absolute) -
Selected Daily Prices

Commercial Banks	Prices as at				
	June 30, 1993	July 30, 1993	Sept. 1, 1993*	Dec. 14, 1993	Dec. 31, 1993
Bank of Commerce	3.85	3.80	4.06	4.20	4.10
Republic Bank Ltd	5.50	5.30	5.33	5.80	6.00
National Commercial Bank Ltd	1.05	0.80	0.81	-	-
Royal Bank Limited	4.26	4.65	4.85	5.21	5.25
ScotiaBank Limited	6.00	6.00	5.71	6.13	6.45
Trinidad Cooperative Bank	2.15	2.00	2.00	-	-
Average Prices	3.80	3.77	3.79	5.33	5.45
Average Price $1 ordinary share (banks excluded)	2.37				

Source: Trinidad and Tobago Stock Exchange.

* NCB's and TCB's shares were suspended from trading in September 1993.

After its failed attempt to acquire all of BOC's shares, Republic was prevented, by the takeover code of the Stock Exchange, from making another offer within a period of twelve months after January, 1994. But because of its accommodation (referred to earlier) it had gained effective control and hence it undertook a restructuring of the Bank of Commerce. One of its earliest acts was to replace the Managing Director of the acquired bank with a senior executive from Republic Bank. A new Board of Directors was constituted, with one of the central figures in the accommodation being appointed Chairman. CIBC was allowed two representatives, owing to its 20% interest in Republic. With effect from July, 1994 the structure of BOC was altered and brought into conformity with Republic's. A number of BOC staffers benefitted, as they were elevated to management positions. Under the previous system each BOC branch had one manager but Republic used a system consisting of separate managers for operations and credit with area managers as overall supervisors.

Prior to July, 1994 a due diligence exercise was conducted by Republic staff and BOC was found to be a "healthy organisation." A decision was taken that both banks would be run as separate entities in competition against each other. However, managers were advised not to aggressively pursue accounts held by Republic, though clients who approached the bank of their own volition were not to be discouraged. One of the early initiatives taken by the new managing director was the engagement of a change management consultant to address managerial staff, with a view to open and frank discussion and airing of concerns. This approach was later expanded to include the entire staff whose views were solicited through small focus groups. Even though the intention was to include the views of staff in the decision-making process and thereby raise their level of comfort under the new management, it was not totally effective. People were still very troubled by the acquisition and many felt that the culture of the two banks was incompatible. BOC was known for its emphasis on service while Republic was perceived as an insensitive bank. Several managers either sought early retirement packages or moved on. The other banks saw this as

an opportunity to attract both staff and clientele who might have been unhappy with the changed circumstances.

After July, 1994 and up to early 1995, a lot of time and resources were expended in streamlining the operations of BOC, forms were being changed and new policies implemented. Managers and supervisors from the acquired bank were being trained alongside their counterparts from Republic, and a number of activities were undertaken jointly. An integration team, comprising senior executives from both organisations, with responsibility for advancing the integration of the two banks, was identified. There were various task forces which reported to the integration team. The team determined that the process would be conducted in stages with the Head Office and specialist functions being integrated first. Perhaps the first area to be integrated was the credit card operations; BOC card holders were, at renewal dates, issued with Republic cards. Cost savings were therefore being realised from very early in the process. While Republic was a larger, more profitable bank, it was discovered that it was not superior to BOC in all areas of operations. For instance, the Instalment Loans 2000 (IL2000) system used by BOC to update and post new loans was superior to Republic's system which was, at the time, manually updated. BOC also boasted of a Private Banking Unit which Republic did not have, and its customer service was widely recognised as the best in the industry. The integration team was therefore charged with the responsibility of identifying and weaving together the best elements of both organisations.

The new management at BOC seemed to have had a positive impact on its performance by the end of 1994. Between 1991 and 1993 BOC's profits declined by 25.8% while most other banks enjoyed increasing profitability (see Table 22). Following the acquisition in early 1994, and the internal adjustments made, the bank's profits jumped by 44.5% over the previous period. In 1995, its performance was more creditable, profits increasing by 63.4% over 1994. Republic's profits over the corresponding periods declined by 12.2% in 1994 and rebounded to increase by 70.8% in 1995 (See Table 22). It should be noted that liquidity, which was extremely tight during 1992 and 1993 improved by

1994 and hence interest rates began to decline, and this might have triggered investors' willingness to secure additional credit. In addition, the economic climate was steadily improving owing to huge capital inflows into the petro-chemical sector. All of these factors combined must have impacted on the BOC's performance. In fact, the Managing Director, in the bank's 1995 *Annual Report*, p. 7 suggested that the 1995 performance was the best by the bank since localization in 1979. But BOC's efficiency which had been declining up to 1993, improved in 1994 and evidenced further improvement in 1995 (Table 25). The improvements in this area, in particular, seem to suggest that superior management and improved techniques, brought to BOC by the merger, may have resulted in improved performance. By 1995, therefore, Republic Bank had begun to realise the benefits it expected from acquiring BOC. But in early 1995 it encountered problems which diverted its attention away from merger activities and focused its attention on its own survival.

To achieve effective control of the Bank of Commerce, after being blocked by CLICO, Republic Bank had reached an accommodation with some allies. By 1995 CLICO seemed to have responded to that event with their own strategy that left the bank "Kicking and Screaming." In March 1995 one of CLICO's top officials, who was strategically positioned at the head of the T&TEC Pension Plan Management Committee negotiated the purchase of 5,731,756 Republic Bank stock units from the Pension Plan by CLICO and Viveka Holdings Limited.

Republic Bank complained to the Stock Exchange that the official used his position as Trustee of the Pension Plan's funds to negotiate the sale from T&TEC to CLICO and Viveka, companies in which he was a Director.[131] In April, 1995 the Stock Exchange advised Republic that CLICO and Viveka had acted in concert and called upon them to proceed with an offer for the remaining

131 Viveka Holdings Limited, a company owned by five C.L. Financial Limited Directors (parent company of CLICO) purchased 7.3% of the bank's shares.

shareholding of Republic Bank. No offer was made by CLICO.[132] Also in 1995, Republic Bank proposed an outsider to replace the retiring Managing Director in preference to the Deputy Managing Director, who was being groomed for the position. CLICO objected to the appointment claiming that as majority shareholder it was not consulted. Republic Bank viewed CLICO's increased shareholding (then 41.0%) and its attempt to determine policy issues in the bank as a hostile takeover bid, and therefore called upon the Central Bank to determine whether CLICO and its Directors were fit and proper persons to be the controlling shareholder in the bank.

In response to Republic's assertions, CLICO claimed that Republic refused to register shares acquired from the Port Authority Pension Funds and to consult them in the appointment of a new Managing Director. The saga continued into 1996 and in July CLICO sought to replace the bank's Board with its own nominees. After expending considerable resources in the "struggle" with CLICO, both sides in a joint Memorandum of Agreement issued in August 1996 agreed to a resolution of differences.[133]

The difficulties encountered with CLICO did not prevent Republic Bank from focusing on its complete acquisition of the Bank of Commerce. In 1996, the bank purchased Agrippa Limited and VHS Limited, which together held 25% of the outstanding shareholding of BOC, bringing its shareholding to

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132 Republic Bank contended the CLICO and Viveka (whom they perceived as one and the same) breached the Takeover and Mergers Code of the Stock Exchange by refusing to comply with the instructions given by the Stock Exchange. But the takeover and merger code is a voluntary one, which does not have the force of law behind it.

133 Much of the discussion in this section was summarised from a circular letter to Shareholders of Republic Bank dated July 15, 1996.

48.0% and thereby triggering the takeover code.[134] A cash offer was made for the remaining shares but the bank only acquired an additional 20.4% to carry its total shareholding to 68.4% by September 1996. In 1996, it also invested a further US$32 million in order to maintain its 20% shareholding in CIBC West Indies Holdings Limited. Bank of Commerce was fully subsumed in Republic by 1996 and its performance was reported alongside other subsidiaries in the Group.

In February 1997 an agreement was finally reached to end hostilities with CLICO, who were allowed to nominate four Directors in an expanded Board. As a result of the truce, CLICO sold its 20% equity in BOC, and Republic was able to acquire the holdings of both the National Insurance Board and the Unit Trust Corporation, taking its shareholding to 95%.[135] In 1996 Republic had offered $6.93 per stock but the same institutions rejected the offer. CLICO's 8.0 million shares which were worth $42 million prior to the truce were purchased for $56 million, at $7.03 per share. By July 1997 Republic had acquired the entire shareholding of BOC, the remaining shares being bought for $7.03 each.[136] Not long after, it put out a rights issue of $600 million, the first time since 1972 that it had requested additional capital. Of course, this was related to its expansion policies, including the acquisition later that year of a bank in Guyana. On October 1, 1997 the assets of BOC were vested into Republic Bank thus effecting the legal merger. Between that time and June 30, 1998, when the operational merger was completed, BOC was known as a division of Republic Bank.

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134 The Takeover Code appears to have been patterned after that obtaining in the United Kingdom. Any person or group acquiring 30% or more of the voting rights of an institution must make an offer for all of the shares.

135 Reported in the *Trinidad Guardian* February, 22 1997 p.1.

136 Republic Bank spent $77 million to acquire 10.9 million BOC shares, amounting to 26.8% of the issued share capital, from NIB, the Unit Trust Corporation and CLICO, reported in the *Trinidad Guardian* February, 22 1997 p.1.

The management at Republic had set themselves a merger deadline of June 30, 1998. Several major activities had to be completed before that time, some related to staff issues, others to operations and premises. With respect to staff issues, these involved the training of over 2500 employees, who took one or more of 24 different merger-related courses, estimated by Republic at 8,800 man-days in training time; and the determination of separation packages. Regarding the operations and premises, it involved the conversion of accounts, systems and procedures, and the rationalisation and physical alteration of branches to bring them into conformity with the appearance of existing Republic branches. The Commerce Division of the Republic Bank comprised 16 branches and a staff of approximately 1000 persons.

In the course of the rationalisation process two former BOC branches were relocated.[137] About 22% of the total staff or 554 persons applied for separation packages, with the majority (98%) of persons being clerical staff.[138] Females accounted for 78% of overall applicants, but this largely reflects the ratio of females to males employed in the bank. Surprisingly, however, Republic staff comprised 56% of those applying for separation. Only 44% of total applicants were granted packages and out of that number 44% were former BOC employees. In terms of costs associated with the rationalisation activities, $35 million was provided in 1997 and $25 million in 1998 for exceptional expenses related to the merger with Bank of Commerce. However, Republic Bank projected that savings of $15 million would result from the staff rationalisation exercise.

Those members of staff who opted to remain with the integrated organisation were placed based on a "best fit" policy. Republic Bank created a number of new positions of General Manager to

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137 For all intents and purposes those branches were closed and the staff and accounts relocated to alternative sites.

138 Persons allowed to apply for separation packages had to have a minimum of five (5) years service.

accommodate the expanded organisational structure. The top three senior executives of the former BOC received positions of commensurate standing and the majority of "new" staff received salary increases.[139] However, a number of junior management and supervisory staff had their level of responsibility lowered, and lending limits were considerably reduced. A number of those persons sought employment elsewhere.

Following the merger, the Managing Director of Republic Bank is reported to have said that the mission of the merger was *"to create ... a dynamic, market driven, relationship and results-oriented bank ... which will compete successfully with any financial institution in the Caribbean and will provide excellent services to our customers and superior long-term returns to our shareholders."*[140] Based on his observation we suggest that the merger was pursued because of economic objectives and hence we shall use the bank's performance indicators, before and after acquisition, to determine whether the merger was successful. We note, however, that one year may be considered insufficient time to make definitive statements. We examined three profitability measures: net income after tax; return on assets (ROA); and return on equity (ROE); also three operating efficiency ratios: total expenses to total revenue; non-interest expense to total income, and total expenses to total assets. All statistics are derived from Tables 22, 24 and 25.

Republic's net income after tax increased by an average of 26.4% between 1993 and 1996 but declined to 23.9% between 1997 and 1998. It recorded lower average increases than its nearest rival Royal Bank, which recorded an average increase of 52.2% between 1993 and 1995 and a 47.3% increase between 1997 and 1998. Between 1997 and 1998, Scotiabank recorded a 23.4% increase while FCB recorded a 34.0% increase (Table 22). In

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139 Staff of the former BOC were thought to be the worst paid in the banking industry.

140 See report in the *Trinidad Guardian* August, 08 1997 p. 4.

terms of ROA, Republic performed better than all banks between 1993 and 1997, though all banks evidenced improvement over the period (see Table 24a). Royal Bank superceded Republic in 1998, with an ROA of 2.54% to Republic's 2.46%. In the area of ROE, Republic outperformed its competitors between 1993 and 1996, but Scotiabank and Royal recorded better performances in 1997 and 1998. It should be noted, however, that Republic increased its equity by $600 million in 1997 and this would have impacted its ROE statistics (Table 24 b).

In terms of operating efficiency, Republic's ratio of total expenses to total revenue evidenced significant decline, moving from 83.9% in 1993 to 93.4% in 1997 before improving to 89.1% in 1998. Republic Bank was involved in its struggle with CLICO between 1996 and 1997 and this involved huge advertising and legal costs.[141] As for the other banks, they recorded improved performances over the period, with Scotiabank the industry's best (see Table 25). In the areas of total expenses to assets, and non-interest expenses to total income a similar pattern is observed, with Scotiabank seemingly the lowest cost bank. Republic Bank and its main rival Royal Bank appear to be operating at the same level of efficiency Table 25 (c). Perhaps this reflects the huge expenses incurred by both banks in their advertising and expansion activities. Both banks, in particular, seem to have been caught up in the "Edifice Complex," expending huge sums on impressive Head Office buildings.

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141 Insiders have suggested that costs of the order of $26 million may have been incurred in those years.

Table 24 (a)
Trinidad and Tobago:
Commercial Banks - Return on Assets (ROA)
(1995-1998)

Year	Commerce	FCB	NCB	Republic	Royal	Scotia	TCB	Workers
1985	1.09%	-	0.16%	0.78%	1.14%	1.60%	-3.54%	-
1986	0.75%	-	0.45%	0.25%	1.02%	1.11%	-0.73%	-
1987	0.40%	-	0.05%	0.09%	0.46%	0.91%	0.28%	-
1988	0.64%	-	0.07%	0.16%	0.72%	0.99%	0.24%	-
1989	0.78%	-	0.31%	0.31%	0.54%	1.08%	0.48%	-
1990	0.94%	-	0.13%	0.58%	0.57%	1.08%	0.82%	-0.57%
1991	0.99%	-	0.18%	0.85%	0.69%	1.05%	-	0.04%
1992	0.84%	-	0.18%	0.94%	0.98%	0.78%	-	0.30%
1993	0.64%	-	-	1.94%	1.04%	1.07%	-	-
1994	0.83%	0.06%	-	1.56%	1.49%	1.42%	-	-
1995	1.13%	-0.41%	-	2.02%	1.69%	1.46%	-	-
1996	-	0.52%	-	2.04%	N.A.	1.70%	-	-
1997	-	0.83%	-	2.30%	2.07%	1.86%	-	-
1998	-	0.99%	-	2.46%	2.54%	1.90%	-	-

Table 24 (b)
Trinidad and Tobago:
Commercial Banks - Return on Equity (ROE)
(1995-1998)

Year	Commerce	FCB	NCB	Republic	Royal	Scotia	TCB	Workers
1985	16.89%	-	3.15%	10.21%	15.37%	21.96%	-67.79%	N.A.
1986	11.18%	-	7.51%	3.11%	14.18%	15.54%	-3.19%	N.A.
1987	5.83%	-	0.89%	1.04%	6.53%	12.65%	1.81%	N.A.
1988	9.17%	-	1.43%	1.90%	9.87%	13.72%	6.94%	N.A.
1989	9.95%	-	5.36%	3.86%	7.47%	13.82%	13.35%	N.A.
1990	12.72%	-	2.37%	7.50%	7.82%	12.60%	22.02%	-5.70%
1991	13.76%	-	2.97%	12.16%	10.44%	12.84%	-	0.51%
1992	11.72%	-	1.75%	12.44%	13.92%	9.04%	-	3.34%
1993	9.04%	-	-	20.84%	17.01%	13.39%	-	-
1994	12.41%	0.55%	-	16.39%	15.19%	19.39%	-	-
1995	18.26%	-4.01%	-	24.01%	18.68%	20.14%	-	-
1996	-	4.75%	-	24.24%	N.A	23.03%	-	-
1997	-	7.93%	-	15.51%	16.71%	25.55%	-	-
1998	-	9.42%	-	17.36%	21.94%	26.41%	-	-

Source: Computed from financial statistics in *Annual Reports*.

Table 25 (a)
Trinidad and Tobago:
Commercial Banks - Total Expenses to Total Revenue

Year	Commerce	FCB	NCB	Republic	Royal	Scotia	TCB	Workers
1985	79.80%	-	N.A.	87.45%	86.37%	73.48%	118.81%	N.A.
1986	83.76%	-	94.99%	95.42%	91.53%	79.43%	104.61%	N.A.
1987	91.93%	-	95.31%	99.62%	95.64%	83.26%	94.87%	N.A.
1988	88.51%	-	99.39%	98.66%	94.77%	83.23%	97.36%	N.A.
1989	87.51%	-	97.56%	94.53%	92.95%	83.05%	95.72%	N.A.
1990	84.28%	-	99.24%	91.85%	92.46%	83.62%	92.99%	105.36%
1991	82.74%	-	98.49%	85.95%	90.08%	82.68%	92.02%	99.39%
1992	85.10%	-	98.55%	85.36%	87.83%	87.65%	92.09%	95.90%
1993	89.26%	-	-	83.90%	86.32%	82.57%	-	-
1994	88.24%	99.18%	-	86.56%	N.A.	78.88%	-	-
1995	86.71%	96.72%	-	84.45%	N.A.	78.29%	-	-
1996	-	95.23%	-	91.84%	N.A.	76.03%	-	-
1997	-	91.61%	-	93.37%	N.A.	73.09%	-	-
1998	-	90.74%	-	89.11%	N.A.	72.86%	-	-

Table 25 (b)
Trinidad and Tobago:
Commercial Banks - Total Expenses to Total Assets

Year	Commerce	FCB	NCB	Republic	Royal	Scotia	Coop Bank	Workers Bank
1985	9.21%	-	N.A.	10.99%	10.44%	9.12%	19.11%	N.A.
1986	10.01%	-	11.64%	11.97%	11.05%	9.10%	16.64%	N.A.
1987	10.10%	-	11.67%	11.66%	10.10%	9.30%	8.87%	N.A.
1988	9.94%	-	11.98%	11.80%	10.48%	9.49%	10.29%	N.A.
1989	10.14%	-	12.48%	11.41%	10.30%	9.96%	10.69%	N.A.
1990	8.75%	-	10.81%	10.68%	9.98%	9.23%	10.94%	11.16%
1991	8.28%	-	11.67%	9.58%	9.23%	8.57%	8.67%	7.20%
1992	8.97%	-	12.26%	10.99%	10.30%	10.39%	N.A.	7.09%
1993	9.93%	-	-	9.87%	9.30%	9.32%	-	-
1994	9.71%	10.09%	-	9.54%	8.94%	8.84%	-	-
1995	8.73%	8.82%	-	7.85%	8.66%	8.16%	-	-
1996	-	9.20%	-	9.04%	N.A.	7.88%	-	-
1997	-	9.48%	-	9.88%	11.88%	7.36%	-	-
1998	-	10.01%	-	11.16%	7.97%	7.42%	-	-

Table 25 (c)
Commercial Banks - Non-Interest Expense to Total Income*

Year	Commerce	FCB	NCB	Republic	Royal	Scotia	Coop Bank	Workers Bank
1985	N.A.	-	N.A.	N.A.	72.09%	N.A.	138.58%	N.A.
1986	N.A.	-	N.A.	N.A.	86.09%	N.A.	107.57%	N.A.
1987	N.A.	-	N.A.	99.45%	92.54%	N.A.	90.25%	N.A.
1988	N.A.	-	N.A.	97.97%	90.83%	N.A.	92.60%	N.A.
1989	77.18%	-	N.A.	91.33%	87.23%	N.A.	N.A.	N.A.
1990	74.83%	-	N.A.	87.40%	87.05%	N.A.	N.A.	117.86%
1991	72.87%	-	N.A.	79.30%	83.22%	N.A.	N.A.	98.26%
1992	74.20%	-	N.A.	77.90%	78.58%	N.A.	-	89.31%
1993	81.13%	-	-	75.12%	77.00%	69.90%	-	-
1994	80.66%	98.17%	-	78.68%	76.66%	63.74%	-	-
1995	78.34%	92.83%	-	74.54%	76.80%	63.63%	-	-
1996	-	90.15%	-	83.81%	N.A.	60.22%	-	-
1997	-	83.83%	-	86.82%	74.43%	54.22%	-	-
1998	-	81.93%	-	80.48%	79.48%	51.90%	-	-

*Total Income = Net Interest Income and Other Income.
Source: Computed from Statistics in *Annual Reports* of Commercial Banks.

From the statistics it appears that we cannot reach any definitive conclusion regarding the success of the merger. Certainly, in terms of profitability, Republic's record has been good but it has not been outstanding when compared to the rest of the industry. Its post merger performances in ROA and ROE are not better than before the merger. The much touted economies of scale have thus far not been achieved. As it turned out, the best performing bank in this respect (operating efficiency) is not an indigenous bank but one still connected to a foreign bank. The latter's lower costs may•have been derived from savings associated with its affiliation. But perhaps this deserves deeper investigation.

What, therefore, are some probable reasons why the Bank of Commerce was seen as a good acquisition target? We suggest the following:

i) It was a small bank which was underperforming compared to other banks in the industry.

ii) Its level of profitability was declining, while its competitors appeared to be on an upward spiral after 1991.

iii) Its technology was outdated and modernisation would require a huge capital injection which its parent group was not interested in financing.

The above issues might have prompted Republic Bank (widely perceived as the leading bank in the country) to bid for its assets on the assumption that it could increase BOC's value by accelerating profitability and growth in assets. In addition, by acquiring BOC and thereby increasing its market share it would become more competitively viable. It was Samuels (1972) who observed that the less efficient firms would be taken over by those with superior management who believed that they could improve its performance, and hence pass on the benefits to consumers. Perhaps Republic overestimated its ability or maybe it is too early to tell.

In terms of benefits to the society and consumers, in particular, we have not measured this but casual empiricism suggests that there have been no significant improvements. The level of competition in the industry has not shrunk by the absorption of BOC. In fact a new bank, Intercommercial Bank, was established in 1998 and this may have filled a void if any was created by the absorption of the Bank of Commerce. But there have been benefits from the merger: the shareholders of both banks enjoyed significant capital gains. BOC's shareholders saw their stock appreciate by 85% between July 1993 and July 1997 while Republic's appreciated by 290% between July 1993 and June 1997. The merger literature suggests that target shareholders benefit at the expense of the acquirers but in this transaction the acquirer's shareholders appear to have gained more. Perhaps Republic's strong share price growth is associated with its overall performance and not the merger alone, though some stockbrokers have suggested that banks' stocks on the whole are over-valued in Trinidad and Tobago.

From the shareholder's perspective therefore, the merger has been a success. From the standpoint of the authorities, it has had no negative consequences for the industry or consumers but from the bank's perspective is may be too soon to tell.

Cross-Border Acquisitions

Companies incorporated in Trinidad and Tobago have been more active than their regional counterparts in acquiring regional business interests, both in the financial and non-financial sectors. In the non-financial sphere, Neal and Massy, Ansa McAl and CLICO have been very prominent in a number of regional economies, with CLICO straddling both financial and non-financial sectors.[142] In the financial sphere, CLICO, Royal Bank, and Republic have been the main protagonists, with CLICO

142 Throughout this document we have tended to refer to CLICO rather than its parent group C.L Financial largely because the latter is relatively new (1994) and the former had initiated most of its current activities.

active in both banking and insurance acquisitions. CLICO was perhaps the first Trinidad and Tobago company to engage in a cross-border acquisition when it purchased the assets of both Citibank and Chase Manhattan Bank in Barbados and set up the Caribbean Commercial Bank in 1984. More recently it has continued to pursue its mission of regionalising its operations by acquiring insurance companies in The Bahamas. However, the Royal Bank of Trinidad and Tobago was perhaps the first commercial bank in the Caribbean to acquire banking interests outside of its jurisdiction.

In 1985, Royal Bank acquired the assets of the Royal Bank of Canada in St Vincent and the Grenadines in a joint venture arrangement with Neal and Massy Holdings Limited and R&M Holdings Limited, a company incorporated in St Vincent and the Grenadines. Initially, each party controlled 50% of the assets of the new bank, the Caribbean Banking Corporation, but Neal and Massy sold its interests to Royal Bank in March, 1996 for TT$50.2 million. The Royal Bank saw this acquisition as an opportunity to launch itself into the wider Caribbean, in keeping with its mission to become a regional full-service banking and financial services franchise.[143]

In considering acquisitions, the Royal Bank focuses on countries whose laws and markets they are familiar with throughout the Caribbean. Its strategy is growth through acquisitions, as this is thought to be less costly and more efficient than establishing new banks. In February 1995, approximately ten years after its first overseas acquisition, it acquired the St. Maarten Commercial Bank through its subsidiary, R&M Holdings Limited.[144] Following that acquisition it acquired financial

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143 Reported in its 1986 Annual Report.

144 R&M Holdings was incorporated in St. Vincent and the Grenadines in April, 1985. It is the parent company of the Caribbean Banking Corporation Limited which operates a commercial bank in the Eastern Caribbean. It is also the parent company of the Antilles Banking Corporation and the St Maarten Commercial Bank. It is a wholly-owned subsidiary of the RBTT Financial Holdings Limited.

institutions in Antigua and St. Lucia which were subsequently transformed into branches of the Caribbean Banking Corporation.

In 1996, it acquired the McLaughlin Bank in Curacao (99%) which subsequently became a subsidiary of the Antilles Banking Corporation (see note 144) and the Nevis Cooperative Banking Company Limited (94%) which became a subsidiary of the Caribbean Banking Corporation. It appears that the Royal Bank's acquisitions strategy also involves having a presence where its main local competitor, Republic Bank, is located. To this end it paid a premium price (EC$23.4 million) to acquire the Grenada Bank of Commerce in June 1997, outbidding Republic Bank's bid of EC$15.5 million. But it has not confined itself to acquisitions within the Anglophone Caribbean. Apart from its acquisitions in St. Maarten and Curacao, it recently acquired the First National Bank of Aruba N.V. (100%), in November 1998 and the Chase Manhattan Bank of St Maarten (100%) in January 1999. In the case of the former, the private owners of the institution approached Royal Bank to acquire their shareholdings because they felt that services would be improved if they aligned themselves to a leading regional institution. With its acquisition of the First National Bank, it also acquired that company's subsidiaries, Aruba Trustkantoor N.V., a brokerage and property management entity, and Banco Nacional de Hipotecas N.V., a licensed mortgage bank.

The Royal Bank's guiding philosophy is to expand through acquisitions in jurisdictions and economies which it understands, in which it can analyse the risk, and in areas which are compatible with its existing technology. A team from within the bank undertakes a due diligence test of the target before the transaction is agreed to. Royal attempts to fund acquisitions through equity; however, tax considerations determine whether debt or equity is used. In July 1998, the Royal Bank Trinidad and Tobago Financial Holdings Limited (RBFH) was incorporated in Trinidad and Tobago. The Royal Bank of Trinidad and Tobago Limited is its wholly-owned subsidiary and operates entirely as a banking entity in Trinidad and Tobago. The new structure allows the Chief Executive Officer to focus on

organisational expansion. He is assisted by an Executive Director for overseas operations whose main responsibility is to ensure that those areas are well serviced. The overseas operations are subsidiaries of holding companies which in turn are wholly-owned subsidiaries of RBTT Financial Holdings Limited.[145] In Box A we provide a list of mergers completed up to January, 1999.

The acquired institutions are generally staffed by locals. The RBFH's strategy does not include retrenchment unless it is absolutely necessary. Only in special cases are Head Office staff seconded to overseas operations. However, the following services are provided at cost to foreign acquisitions:

i) Risk management;

ii) Corporate Secretarial and Board Representation;

iii) Technology, inspection and audit services;

iv) Group marketing and product development.

Owing to RBFH's acquisition activities during the past fifteen (15) years no other regional bank is as widely represented throughout the Caribbean. Through its vision it has been able to improve the delivery of financial services to an ever-expanding public. Thus consumers, wherever RBFH is represented, have benefitted from access to improved technology and greater financial resources. It is unchallenged as the leader in acquisitions activity - it may also claim to be the leading financial institution in the Caribbean.

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145 ABC Holdings NV, incorporated in 1997, is the parent company of the Antilles Banking Corporation (St Maarten NV), Antilles Banking Corporation (Curacao NV), and the First National Bank of Aruba N.V. In January 1999, the Grenada Bank of Commerce became a subsidiary of the Antilles Banking Corporation owing to corporate restructuring.

Box A

Cross Border Acquisitions by Royal Bank of Trinidad and Tobago*

Date	Institution Acquired	Country	Percent-age of Assets Acquired	Parent Company After Acquisition
1985	Royal Bank of Canada Grenadines	St Vincent and the Grenadines	100%	R&M Holdings Limited
February 10, 1995	St. Maarten Commercial Bank	St. Maarten	100%	ABC Holdings N.V.
April 3, 1995	McLaughlin Bank	Curacao	90%	ABC Holdings N.V
April 26, 1996	Nevis Coopera-tive Banking Company Ltd.	St. Kitts and Nevis	94%	R&M Holdings Limited
June 5, 1997	Grenada Bank of Commerce	Grenada	60%	R&M Holdings Limited
Nov. 25, 1998	First National Bank of Aruba N.V.	Aruba	100%	ABC Holdings N.V.
Jan. 31, 1999	Chase Manhattan Bank	St. Maarten	100%	ABC Holdings N.V.

* In July, 1998 the Royal Bank TT Financial Holdings Limited was incorporated; the Holding companies identified above are fully owned subsidiaries of that Company.

Source: *Annual Reports* of Royal Bank (several years).

If there is any local financial institution which can be considered close rivals of the Royal Bank, it is the Republic Bank. Both have engaged in fierce competition locally as well as regionally, sometimes bidding for the same target in regional economies. However, Republic Bank is not as widely represented as RBFH. Republic Bank's vision is to become a regional bank through overseas expansion. It believed that in order to achieve that status it needed to become a strong domestic institution; perhaps it has achieved that critical mass with its merger with Bank of Commerce. Its strategy, like that of RBFH, appears to be growth through acquisitions in order to improve its services, returns to shareholders and to spread its risks. Its cross-border acquisitions activity commenced in 1992. Table 26 gives an indication of the close rivalry which exists between Republic Bank and RBFH.

In 1992, Republic Bank Limited acquired a 51% interest in the National Commercial Bank of Grenada Limited. The former saw this transaction as a way to consolidate its position as the region's premier financial services institution.[146] This subsidiary showed a significant turnaround after one full year of majority ownership by Republic Bank, moving from a loss position of EC$1.5 million to a profit of EC$0.6 million at fiscal year-end 1993. By September 1998 it achieved after tax profits of EC$5.1 million, a percentage increase of 11.3 % over 1997.

In February, 1994, Republic acquired a 20% shareholding in CIBC West Indies Holdings Limited in a strategic alliance which facilitated its acquisition of Bank of Commerce. CIBC West Indies Holdings Limited was incorporated in Barbados in 1993 and has three main subsidiaries CIBC Caribbean Limited, CIBC Jamaica Limited, and CIBC Bahamas Limited. Through its strategic alliance with CIBC, Republic Bank has been able to diversify its portfolio, spread its risks and improve its returns to shareholders.

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146 See Chairman's review p. 16 of Republic Bank 1993 *Annual Report.*

Table 26
Comparative Statistics - Last Two Reporting Periods
TT$ million*

Variables	Royal Bank of TT Financial Holdings Company Limited			Republic Bank Limited		
	1997	1998	% Δ	1997	1998	% Δ
Total Assets	11,817.4	11,865.5	0.41	11,793.9	13,932.4	18.1
Net Profits After Tax	193.0	224.9	16.5	169.3	205.6	21.4
Earnings per share**	1.30	1.43	10.0	1.34	1.24	(8.1)
Shareholders Equity	871.8	1,363.0	56.3	1,026.9	1,137.9	10.5
No. Of Issued Shares	147.4	170.1	15.4	119.3	159.0	33.3

* Republic Bank's year end is September 30 annually while RBFH's is March 31, hence we simply compare the last two report years of each institution.

** Earnings per share is reported in actual dollar value.

Source: *Annual Reports* of Institutions.

In October 1997, it acquired controlling interest (51%) in the National Bank of Industry and Commerce (NBIC) in Guyana. The latter is the largest commercial bank in that country, with assets in 1996 of US$167.8 million, and was at the time majority-owned by the State. The Government of Guyana had taken a decision in the early 1990s to divest itself of its ownership interest in state enterprises. The State held 47.5% of the shares in NBIC; 30% was held by the Central Government and 17.5% by the National Insurance Scheme. Republic acquired those shares for US$20 million, and subsequently increased its shareholding to 51%, thereby gaining control of the bank.[147] Republic set itself a target of increasing overall market growth by 15% per annum and of increasing market share through aggressive marketing but this was not achieved at the end of fiscal 1998. Incidents such as the political unrest and the effects of the *el niño* weather conditions played havoc with the economic activities and affected the bank's performance. As a consequence of those events and increased provisioning for loan losses, in keeping with prudential guidelines, the profit out-turn for 1998 was below expectations.

As we stated earlier, Republic Bank and Royal Bank are the only two banks from Trinidad and Tobago, perhaps the Caribbean, which pursued cross-border acquisitions. Owing to these activities they are virtually unchallenged as the leading indigenous commercial banks in the region. In Box B it is evident that Republic Bank has engaged in fewer mergers than its main rival.

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147 Reported in the *Trinidad Guardian* March 28, 1998 p.1.

Box B

Acquisitions by Republic Bank Limited

Year	Institution Acquired	Country	Percentage of Assets Held
1992	National Commercial Bank of Grenada Limited	Grenada	51%
1993	CIBC West Indies Holdings Limited	Barbados	20%
1997	National Bank of Industry and Commerce	Guyana	51%
1997	Bank of Commerce	Trinidad & Tobago	100%

Source: *Annual Reports* of Republic Bank Trinidad and Tobago Limited

Chapter 7

Concluding Thoughts

From our survey two different rationales can be put forward for the kinds of mergers occurring in the countries represented in this study. The majority have resulted from "regulatory intervention," as opposed to "own initiative." In the case of the former, involving mergers within a country, the vast majority have been initiated by governments, initially as a means of localising the financial sector and placing control over financial resources into local hands, followed by a period of divestment of government ownership. More recently, mergers have resulted from government intervention to avert possible crises in the respective financial systems. In a few cases, economic motives were present as some institutions saw mergers as an opportunity for expansion and growth. In the case of cross-border acquisitions, economic motives have been the compelling reason.

Traditionally., among the reasons put forward to justify the vast majority of mergers are benefits derived from economies of scale and synergies. But there is no automatic reason why such benefits should result. In all of the countries surveyed there has been very little evidence of those benefits. The question is often asked whether unemployment is axiomatic following the merger of two banks. Of course, unemployment appears to be inevitable in those circumstances but it is not consequential of mergers alone. The liquidation or failure of banks also leads to unemployment. Indeed, the mergers may have saved jobs. In this age of information technology, job security is perhaps lower than in any previous decade, and besides, no country's economy can grow without inconvenience to some people.

In the case of Guyana, and the merger of GNCB and GAIBANK, while we recognise that individual countries have overall development strategies which inform or determine the institutions that are allowed to develop and are therefore supported by the State, we believe that no value has been added by the merger of those two institutions. Of course, a case could have been made for the restructuring of GAIBANK because of its specialist role. But, given the Government's divestment initiatives, we wonder why GNCB was not put up for sale. Politics and politics alone seemed to have influenced the decision to support the continued existence of GNCB. To our mind, the Government would have acted more responsibly if it had divested GNCB and used the resources derived therefrom to restructure GAIBANK, in order to make it into an effective institution. We wonder, in the absence of a mechanism designed to help entrepreneurs acquire capital assets, how the small to medium-sized business sector would fare. Perhaps that role is now subsumed in GNCB functions. A considerable amount of capital has been expended over the years in keeping GNCB afloat; capital that might have been employed more fruitfully in seeking improved opportunities in other areas.

The divestment of GNCB would have been consistent with Government's stated policy and it could have been done through another means. For instance, GNCB could have been absorbed by NBIC prior to sale of the latter. In the same manner that the Government treats with GNCB's losses, they could have exorcised its bad portfolio and sold its "good" assets to NBIC. However, after the merger, the Government found itself owning a bank which was severely capital short and lagging behind its competitors in technology. It survives only because its majority shareholder is the State. The key factor determining the success of a merger is the quality of planning and management. It is the people involved and the combinations of their various talents and abilities which could positively impact the decision making and operational activities. If the sum of management competence is inadequate to the task, the merger may fail. In the case of the GAIBANK/GNCB merger, an administrative decision caused the merger but no additional competencies or advantages were

brought by the new partner; instead, two weak and struggling banks were merged. This is a recipe for failure.

The most appropriate solution would have been to merge GNCB, the weakest bank in the country, to NBIC, the strongest bank. Moreover, because the state had controlling interest in NBIC, it could have used its position to facilitate the transaction. NBIC's technology and management capability were far superior to GNCB's, and its staff were committed. The resources expended by Government in supporting GNCB could have been more usefully employed in the transformation process, after merging GNCB to NBIC.

In the case of the FCB merger, all three banks, at some stage before the merger underwent periods of financial fragility. Sheng (1996) defines financial fragility as the deterioration of bank solvency due to poor asset quality and declining profitability. He contends that a central problem in the global banking system is that irrespective of public or private ownership of banks, there is an unwillingness of governments to allow banks to fail for fear of systematic failure. Bank management was free to take risks far beyond prudential levels because losses were ultimately borne by the state. By providing the liquidity support for the troubled banks before the merger, the State might have been shielding the institutions from the realities of the market place. It was minimising the problem of moral hazard. Moral hazard is a term used by economists to refer to anything, e.g. insurance or government subsidy, that encourages risky behaviour by financial risk takers who believe that they will reap the benefits of the risky investments they make while being protected from the losses. Providing support for insolvent financial institutions involves moral hazard. Bankers were therefore free to take risks since the State was willing to bail them out when they found themselves in difficulties.

The merger of TCB, NCB and Workers Bank seemed to have been consummated to ensure the mininisation of bailout by the DIC and therefore the limitation of burden on taxpayers, and to protect the financial system from crisis owing to the possible failure of three banks. Since banking is central to the economic

success of a nation, the wider economic implications of failure had to be arrested. Changing economic circumstances revealed risk exposures, and the potential for widespread losses at both NCB and Workers. Perhaps Workers developed abnormal risk concentration during a period of rapid growth in the mortgage market. As the growth continued, credit standards deteriorated, and the economic downswing exacerbated the problem. While we believe that the Government should have acted sooner, its action was not too late to avert a possible crisis. The Government, through its supervisory agency, must be prepared to take steps to avoid failure of a significant share of the banking sector but, we believe that it should not prevent individual banks from failure. Moral hazard should always be allowed to act as a check or balance on financial institutions. In its absence, bank managers would be less willing or inclined to exercise the utmost control and deliberation, even discipline, in their lending activities. The most important element in a sound banking system is not deposit insurance; it is a strong, effective banking supervision department, supported by an appropriate regulatory framework.

With the formation of FCB, the Government not only preempted a possible run on NCB but it also injected new life and hope (through its financial guarantees) that allowed the new institution to find its way. In the TCB/NCB/Workers merger, there was a pooling of resources and capabilities of the three banks. Perhaps the Government believed that through this action more effective use could be made of the joint resources and capabilities and scope and scale economies derived. The new bank might have been hastily put together but its management showed much deliberation and planning in executing its functions. In its rationalisation and restructuring process it sought to strengthen its senior management with experienced bankers who were attracted away from its competitors with the promise of huge salaries and perquisites. Its initiatives paid dividends. It has had a beneficial impact on the financial system, both from the viewpoint of restoring public confidence, which would have been severely eroded had the action not been taken, and also because the new bank has been showing improvement. In the FCB merger, the former shareholders were losers; their share prices were seriously eroded and they faced the prospect of

little returns. But it was their decision and investment risk and losses must be borne by the investors. The society at large, however, benefitted from the merger.

In the case of the three merged banks, all of them emerged to satisfy a need for financing which the established foreign-owned and controlled banks left unattended. They were, therefore, critical, in terms of widening the opportunities available for investment financing. Their lending policies, as a result, tended to be more accommodating than the other banks and hence they ran into problems which threatened not only their viability but the health of the entire system. The negatives about the indigenous banks are easy to recall but what seems less well-known is the significant impact they had on changing the face of banking, not by being the most profitable or sound banking institutions, but by introducing new products and services aimed at attracting away clients from the established banks and hence increasing the level of competition. The effect was a stronger banking system, providing better services to the country.

It is an interesting question to pose, and we do not have the answer, but what would have been the fate of the Trinidad and Tobago financial sector if the troubled banks were allowed to fail? Bank failures are not necessarily bad. The exit of weak individual banks is critical for the maintenance of a strong banking system. Moreover, experience has shown that unsound banks are invariably in worse condition than is indicated by their financial statements, and that the lowest cost way to keep the banking system sound is to force the early exit of unsound banks (Benton E. Gup, 1998 p. 11). Perhaps, in the case of TCB, its failure might have had minimal impact. It was the smallest of all commercial banks and was perceived by many in terms of its original name "the Penny Bank." We do not believe that its failure would have compromised the integrity of the system. Much the same reasoning could be applied to the Workers Bank since it, too, was perceived as a weak bank prior to its rescue in 1989. In any event, the DIC was already established and could conceivably have provided relief to depositors. It is the failure of NCB, however, which we believe would have sent shock waves throughout the system, largely because of its size and the scope

of its operations. As the largest of the three banks, NCB was well established, with branches throughout the length and breadth of the country. Its failure would have impacted a broad cross section of interests and hence there was the potential for crisis. From the view point of ensuring stability of the financial system, therefore, the Government's action appears to be justifiable.

The merger between Republic Bank and Bank of Commerce was undertaken for purely economic reasons. Bank of Commerce was a small bank, that was majority-owned by a Canadian bank which was not satisfied with its returns, and which was unwilling to expend huge capital to update the BOC's technological capability to make it competitive. Republic Bank saw the merger as an opportunity to expand its market share and to acquire assets which it could employ more effectively than the former management. It was simply an investment decision, rationalised on economic grounds to promote the interest of Republic Bank and its shareholders. But this action may have had benefits for the wider society in terms of externalities. Certainly the merger has not reduced the level of banking services, nor has it increased the monopoly power of the remaining banks. It may have forced the remaining banks to strengthen their operations in order to avert the possibility of they themselves being considered takeover targets. It has also increased public awareness and knowledge about mergers and forced the monetary authorities to rethink regulations to keep pace with modern initiatives.

There has been little or no negative fallout from the Republic/ BOC merger. Customers of the former BOC now have access to a large bank offering a wider range of services and products. Perhaps the only down side is the increasing bank charges, but these have had an upward trend in all banks during the 1990s, partly on account of the huge costs incurred in updating technology and also because commercial banks have begun to focus on fee income as an important source of revenue. Regarding the shareholders of both entities, both parties received windfall gains. The target shareholders received premium prices for their stocks, and the acquirer's shareholders saw their stocks improve five-fold. This merger appears to have been influenced by managerial motives, or at least those motives

dominated the others. A number of new executive management positions have been created post-merger, with the incumbents receiving better compensation packages, as well as improved status.

With respect to mergers occurring in Jamaica, government intervention was required. Even in the case of the merger promoted by private interest, the impact of weak legislation and supervision by the authorities, combined with a sluggish economy, forced the government's action. The merger of NCB and Mutual Security Bank might have come about due to managerial motives since the owners/majority shareholders felt it was a good way to combine their assets and increase their financial sector status. But the planning or execution of the merger seemed to lack good and precise thinking and hence its consummation might have been ill advised. Indeed, it appears that bad planning was only exacerbated by a difficult period in economic life of the country. The remaining mergers were the administrative alternative to bankruptcy and crisis in the Jamaica financial system. The Government, simply, could ill-afford to allow that many banks to fail. There would have been catastrophic implications for the country, even region-wide implications. Perhaps, though, the failure of those banks had more to do with an inadequate legal framework which complicated supervision, thus undermining the soundness of the banking system; the existing legislation gave inadequate power of intervention, sanction and enforcement to supervisors. Bad debts do not occur overnight, but they can quickly build up over two or three years. Sheng (1996) contends that once they exceed 10% of total loans, the likelihood of bank failure looms large unless the banking system is owned by the Government.

Some may wish to argue that the failure of Jamaican banks resulted from exposure either to geographic or sectorial over-concentration. But this simply reveals bad decisions by bank management, and inadequate supervision. Connected lending has also been part of the problem. In almost all countries where there have been bank failures connected lending between banks and their shareholders was found to lead to serious problems. This occurred in both Jamaica and Trinidad and Tobago. The

deterioration of the bank portfolio and its rescue by the state have large monetary and fiscal implications because of the likely feedback effects that can lead to macro economic instability. Expert manoeuvering by both countries have thus far forestalled this threat. But at what cost? The economy is virtually at a standstill, particularly in Jamaica.

A 1988 study by the US Comptroller of Currency found that US bank failures could be attributed to poor asset quality in 98% of cases and poor management in 90%, but a weak economic environment was a factor in only 35%, and fraud an issue in only 11%. In developing countries, like those of the Caribbean, it was suggested that the economic environment might play a larger role but not greater than 50% (Sheng, 1996). Good management is therefore essential to success. In the Jamaican financial sector, management was weak; perhaps in both Guyana and Trinidad and Tobago, the difficulties of some banks can be attributed to weak management also. But the supervisory institutions must also share the blame. One common thread throughout the region is that banking regulations have not been adequate - most have been recently revised. There have been suggestions that perhaps further revisions are necessary. In none of the countries, except Jamaica, are there detailed regulations dealing with the issue of mergers, even though such occurrences are now a feature of economic life. The primary focus of our institutions and of the regulators needs to be shifted from preventing bank failures to ensuring that adequate banking services are maintained and depositors protected. The former involves specific rules governing mergers, the latter involves the creation of institutions such as DICs and good supervisory monitoring. More attention should be paid to these.

Our analysis has not been able to show conclusively that the mergers occurring in the Caribbean have been beneficial, using the financial criteria for analysis. However, we believe that had the Governments not intervened and facilitated mergers greater crises would have emerged, hence the authorities appear to have been successful, at least in averting greater financial crisis. Perhaps with the increase in cross-border transactions future studies can provide better insights into the success of mergers

based on economic considerations. What we have shown, at least, is that the traditional motives for mergers have not been the main rationale for the regional activities in this area. Interestingly, however, the majority of mergers resulted from attempts by the State to rescue failed banks, and this, as a reason for mergers, has been advanced since the 1960s when Dewey contended that they are civilised alternatives to bankruptcy. In small countries, like ours, the art of "Statecraft" to use a term borrowed from Trevor Farrell, is still being refined. Indeed in many areas, State participation in economic life is perhaps too large but until we are able to have more viable economies, there appears to be no immediate likelihood of change to the structure.

Policy Initiatives

From our investigation it appears that several policy initiatives are urgently required.

In all of the countries studied, state-owned commercial banks or "home grown banks" have not enjoyed the successes of the commercial banks which evolved from foreign commercial banks or continue to be foreign-owned. Perhaps it is trite to say that state ownership removed the problem of moral hazard. However, given the difficulties encountered by those institutions, it is clear that managers of such banks did not exercise the required discipline in their operations, secure in the knowledge that the Government would cover losses. This situation was compounded by weak and ineffective supervisory institutions in most of the Caribbean countries. This latter issue was evident in the three countries surveyed. More recently, new regulations have been enacted but these already need revisions since financial innovations brought about by the globalisation of markets are forcing banks into new areas for them to remain competitive. The regulations have to keep pace with changes in the environment and sometimes precede them if properly anticipated. In fairness to the authorities, however, the level of monitoring has been improving in the late 1990s. Sometimes, I believe that our policy makers tend to treat issues in the context of imminent crises rather than to consider comprehensive policy reviews consistent with changed circumstances.

The clear policy conclusion here is that all remaining state-owned banks should be privatised. Most countries have already begun to pursue that strategy but in the countries surveyed Government ownership continues. The Government's focus should be confined to promulgation of regulations, and monitoring to ensure stability of the financial system.

In none of the countries are there units or agencies, either within the Central Banks or Ministries of Finance, specifically mandated to approve mergers, monitor them or even regulate such activity. Certainly the phenomenon is not as widespread in the Caribbean as in the developed countries and hence it can be argued that such a unit may be under-utilised. Still, there are currently no known criteria established by law or otherwise for determining whether any Caribbean merger is in the public interest. This situation needs to be remedied. We do not think it far-fetched to suggest that such activity will continue or even increase in other financial institutions, such as insurance companies and credit unions. With respect to the latter, out of about 150 credit unions supposedly active in Trinidad and Tobago, many are relatively inefficient and several close to failure. Already there have been initiatives by the IDB aimed at institutional strengthening. The existence of a Merger Advisory Agency could lead to required action that could promote a stronger sector resulting from a rationalisation through mergers.

Recent research being undertaken by this author provides strong evidence that throughout the region, each country possesses a number of small, weak credit unions, some of which are close to failure, with others finding it very difficult to survive. It is widely recognised that mergers are the only way to reduce over-capacity in the credit union sector. In the case of the regional insurance sector, many of the companies were established in boom times, when business prospered. However, the current economic realities of most countries have reduced a number of companies into non-viable operations. In Trinidad and Tobago, the insurance sector is comprised of more than twenty service providers. Are these not too many for a small market like ours, with a population of 1.3 million citizens? In the 21st century it is inconceivable that the large number of credit unions and

insurance companies can survive and remain competitive. The market is too saturated, and while we cannot speak with assurance, we believe that some of the insurance companies may be under-capitalised. In the circumstances, it is either mergers or bankruptcy! The situation is similar for credit unions in other parts of the Caribbean. There are simply too many for all of them to be successful.

We have suggested that in some cases weak management was responsible for the poor performance of commercial banks and in the case of Jamaica, in particular, poorly trained and ill-prepared managers appear to have been culpable in the failure of banks. In this connection, we believe that special requirements should be established, in terms of professional qualifications and licensing for commercial bank managers. In our view, bankers should be subject to entry conditions similar to those of lawyers and insurance professionals. In both instances, these professionals are required to successfully complete professional training before being fully inducted into the fraternity. In fact, the Inspector of Banks should be responsible for issuing licences to managers after satisfying himself of the persons' suitability. Of course, this is not a foolproof guarantee against weak management, but it will be a step in the right direction. The Institute of Bankers in conjunction with the Inspectors of Banks should be mandated to hammer out certain acceptable industry standards for bank managers around the region. Another reason why we believe it is important to have well trained managers is because of the increased level of competition in the financial sector. Small financial institutions will have to engage in riskier transactions in order to remain competitive, and consequently the skills of the managers have to match the complexity of transactions. Perhaps this is another cogent reason for our small banks to consider mergers.

As we enter the 21st century we must ask ourselves whether our financial systems are strong and whether they can survive and compete in the global village. In a small region like the Caribbean, is the presence of the vast number of banks justified? Should there not be more mergers aimed at producing strong, enduring institutions? Given that the future of the region

appears to lie in a Single Market and Economy, perhaps a single currency, should we not consider what is likely to be the minimum efficient size of a commercial bank? Perhaps, two of the Caribbean's leading financial institutions, Republic Bank and Royal Bank of Trinidad and Tobago could amalgamate into a regional giant and achieve the size needed to compete globally. But would they consider it? Already the brand name of RBTT is becoming well-known throughout the region as it continues to acquire financial institutions in various jurisdictions. We think that this is a positive initiative that should be applauded. We hope that regional governments recognise that small state-owned banks, even though successful now, are likely to come under tremendous difficulties within the current decade. Our forecast is for continuing merger activity that may result in only three or four Caribbean banks.

I have a dream, a dream that one day soon, banks as we know them today will no longer exist; in their place will be very advanced ABMs which will offer every transaction required by retail banking customers. This is only a dream, but it seems all too real for me to dismiss it completely! Whither Mergers?

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