CHAPTER 1 - INTRODUCTION

1.1 Introduction

In the aftermath of the recession period that occurred a few years ago, analysts and experts realized far too many mistakes and shortcomings in the economy and business domain. Chief among them was the absence of a proper and thorough analytical framework to aid in the implementation and management of mergers in the banking and finance sector. Research in this regard alludes to the emergence of a phenomenon that was characterized by vast financial inequities and disturbances that led to a economic free-fall, which has caused seriously-damaging macroeconomic outcomes, and ridden the markets in more dilemma and complication (Garzella and Fiorentino, 2014; Gragam, Harvey and Puri, 2015). In the banking sector specifically, widespread discussions have been ongoing on the topic of mergers. Researchers have come to observe that there has been rather dismal success that has been achieved by different corporate entities, to proactively push and implement a merger process – particularly against the backdrop of dynamic economic output and low interest rates (Appelbaum et al., 2017; Bena & Li, 2014; Collett 2015). Scholarly consensus suggests that decision-making has been the weakest link. Further to this, there is also been rampant impudence, that organizations are readily well-equipped to self-adapting to any scenario. This tendency has led to companies clearly underrating the outcomes caused due to overlaps in decision-making in mergers. As it is, role of decision-making in the context of mergers and acquisitions has not received the importance and recognition which otherwise it merits.

As far as policy is concerned, there appears to be a dire need in the banking sector for an analytical model to be designed and duly implemented so that mergers can be well-managed and executed. In the recent past, research conducted in this context has been one-dimensional. Mergers have been studied through a comprehensive perspective. With the passage of time, demand for the adoption of an analytical model, which is centered on and supports decision-making processes, has grown significantly (Hoefer and Green, 2016; Uzelac et al., 2016). The frequency and need for this demand to be fulfilled has gained momentum particularly ever since the recent financial crisis happened. Consequently, academic interest and research in this direction has also become widespread. Literature developed recently primarily focuses on the role of decision-making in mergers and acquisitions, and how it is an important factor in their

overall management. Besides, challenges and hindrances which are likely to surface in strategic decision-making in the event of mergers and acquisitions have also been put under meticulous analysis. This has been done so that appropriate theories and approaches could be identified and used to construct a fitting conceptual framework. For the purpose of this research study, a selective compilation of relevant literature sources have been reviewed and analyzed so as to develop an understanding of the chief obstacles and difficulties that possibly materialize in merger-related decision-making processes within the banking sector, albeit in a strategic manner (Atkinson and Gary, 2016; Cobb, 2016; Markes and Mirvis, 2015). Empirical evidence in the decision-making domain of this subject has been limited thus far. As a result, availability of concrete findings has been very minimal or nearly nil. Nonetheless, this research study has analyzed the limited empirical evidence. It resulted in discovering that there is no solid analytical framework that could be enforced in the banking sector. Also, findings revealed that insufficient focus is meted out to the decision-making process, development and implementation of appropriate models or approaches in the banking industry. Therefore, the following research invests an effort to propose a developed analytical framework that can be adopted by banking institutions and public sectors to facilitate support and manage merger-related decisions in the UAE.

1.2 Background

Mergers and acquisitions (hereafter referred to as "Mergers" in this research study), are a strategic growth route that companies opt to adopt in order to further their competitiveness and competitive advantage. It is primarily done to gain a stronger foothold in the target market segment, as well as also advance customer prospects and reach (Bena and Li, 2014; Collett, 2015). Describing mergers, Judd (2016) states that the process entails a mutual consensus between two business entities, to collectively manage and run two or more companies by combining them as one business entity. Materialization of a merger is achieved through investment and sharing of shared funds and other funds. Similarly, Galpin and Herndon (2014) also opine of a merger as an amalgamation of set of companies (two or more) and thereafter the parties involved commit to upholding the new firm's image and value. Researchers have observed that most 'merger' definitions are pinned on the 'combination' aspect, however, failing to focus on the change circumstances that occur and are understood very minimal. These include:

the human inter-dynamics, the organization and reorganization of activities and assets, the financial framework, the company's realities, corporate image and value, number of companies involved , ownership hierarchy, resources allocation, company operations, and legalities involved (Sarala et al., 2016; Schmidt, 2015; Wong, 2014).

Multiple factors govern companies' interest and motivation to see a merger materialize. Synergies of operations are a chief motivator for mergers (Marks and Mirvis, 2015). It occurs when the following factors are combined: complementary resources and skills, economies of scale of the two companies involved, and the availability of scope to achieve great outcomes from the combination (for example: sharing of fixed costs.) Further to this, the aims of diversification, the tax advantages, the synergies of financesand the pursuit of the market power are some of the reasons that companies engage in mergers (Lebedev et al., 2015; Stahl et al., 2013). Despite the fast-tracked integration of companies' operations taking place, and based on how popular mergers are, one cannot disregard the fact that mergers suffer from an epic failure rate. Research literature in this context reveals that between 50 to 80 percent mergers do not yield expected success (Gomes et al., 2013; Lebedev et al., 2015; Sarala et al., 2016; Schmidt, 2015; Wong, 2014). A survey by Deng and Yang (2015) led them to discover that it is actually the integration process that is a daunting challenge for companies. They are not very concerned about the success it yields, or any other important related factors, for that matter. On their part, scholars have developed research literature that primarily concentrates on aspects such as market performance and what impact does the merger have on stakeholders' value as far as strategic management and financial outcomes (Sarala, Vaara and Junni, 2017; Stahl et al., 2013) Employee reactions to mergers and the materialization is also sub-domain that has been well-explored and recorded by researchers. They have particularly paid attention to examining merger-effects on their jobs, careers, and how they are to manage the developments overall. At the same time though, there is rather restricted research conducted on the role and impact decision making renders in mergers. Specifically, the influence of decision making in banking mergers is an area that is largely unexplored.

Decision-making is known to have an influence on the integration levels and therefore the approach choice that gets adopted to see the integration through (Han, Jo and Kang, 2016; Girasa, 2013). The integration choice and the decisions thereafter have a crucial role in

determining whether the merger would be successful or otherwise (Ferreira et al., 2014). Besides, in literature there is anyways reams of research and evidence available the focuses on the variables, processes, and factors that have a part to play in mergers' success. At the same time there is no denying that success factors and failure causes of mergers remain quite poorly discerned. In a research exercise led by Huang, Officer and Powell (2016), researchers refer to Teece (1982), and suggest that most frequently-researched antecedent variables are critical performance indicators of mergers. Teece (1982) came to understand that irrespective of the vast research carried out on actions that influence organization performance after a merger has materialized, the domain still is largely left unexamined. Focusing on the under-researched topics and sub-topics in the mergers category, Friedman et al. (2016) in his review identified the following areas that could use further analysis: power differences, speed and time differences, decision-making processes, and trust.

Humphrey-Jenner, et al (2017) emphasize that myriad inconsistencies are widespread in mergers and they can be elaborated upon through variety of means. To begin with, there are several actions which come into play during the merger process, and there still is adequate scope for research and analysis. Exploring these areas could lead scholars and researchers to discover potential concerns and issues which originate via sharing and transmission of resources and skills. Secondly, the discrepancies which surface between the two sides – management teams, which could hinder the process of value creation. Differences in decision-making in companies involved in mergers could trigger ill-attitudes and other negative consequences that could weigh down the acquirer, management, company turnover rate – all of which could throw the company's performance off-balance during and after the merger.

This focal point of this research study is the identification of gaps in the merger process by pinning focus on how operation synergies are realized and how a pertinent decision making framework gets implemented in merger processes. In particular, it I concerns with the espousal of a tenable framework so that successful mergers can be achieved. In respect to this research study, it aims to render insights concentrating on the decision-making process – its role and implementation in the integration of operational synergies in the banking sector. Developing this understanding, this research study aspires to gain better comprehension of the involvement of decision-making processes in the context of mergers, and how all of it collectively adds to

success and value creation in UAE's banking sector. Thus focusing on the influencing factors that support the decisions regarding merging of the firms. In this way, the work intends to develop a better understanding of the parameters that make the adopting of appropriate decision making process which are successful in the context of mergers this contributing to the value creation process and the realization of synergies in mergers within the UAE. In addition, the research expands on findings through a synthesis of prominent research in the merger research streams identified in literature on mergers into an integrative framework and addresses the merger issues with a clear focus on the managerial relevance.

The integrative analytic framework is operationalized as an analytic device as opposed to a prescribe model for the case study for the merger in UAE.

In the UAE, the banks offer Islamic banking services. The service is governed by Shari' a law and the Federal Law No. 6 of 1985 concerning Islamic banks, investment companies' and financial institutions. According to Article 3 of the law, the Islamic banks are granted the right to provide the commercial, financial, investment, and banking operations and services as outline in the Federal Law No. 10 of 1980. The action creates a problem in the operational synergies and dissemination of available knowledge in the merged form post-merger processes.

1.2.1 Historical Development of Mergers

Literature developed in context of mergers' history and evolution, scholars observed and recorded five major waves that came to characterize the historical evolution of mergers. The waves began in the 1890s. The timeline of each wave was: First wave (1897-1904), Second wave (1916-1929), Third Wave (1965-1969), Fourth Wave (1981-1989), Fifth Wave (1992-2000), Sixth Wave (2003-2007), and Seventh Wave (2011-present)

The first wave of mergers commenced in the late 1800s, and was a byproduct of the economic depression ongoing at the time (Harper and Leicht, 2015). The depression was observed to be a mirror-effect of the industrial revolution as it was luring businessmen by the heavy-duty industrial development and high-scale gains. It resulted in the established of several industrial corporations – many of which exist till date in the US, and are the backbone of its economy and global financial system (Harper and Leicht, 2015). The movement further triggered a movement of corporate power consolidation on the basis of cost-cutting, productivity, and lack of

competition in markets. Consequently, it led to the establishment of corporate monopolies in different industrial sectors, and government rulings proved inadequate in preventing the monopolistic environment (Cefis and Marsili, 2015). Therefore, the first wave concluded as failure, as desired outcomes were not obtained. Besides, the government regulation grew stringent as the Congress implemented the first-ever anti-trust law known as the Sherman Act in 1890. The law was considered as a green flag for economic autonomy, directed at protecting free competition as the rule of trade, so that monopolistic competitiveness could be curbed (McCarthy, 2013). A follow-up Law called the Clayton Act was implemented in 1914, an extension that curtails all kinds of monopolistic merger trysts (McCarthy, 2013).

The Second wave occurred between 1916 and 1929. During this phase, the nature of mergers was largely oligopolistic in nature, versus to the first wave (Moeller and Brady, 2015). The aftermath of WWI motivated industrial progress which inspired organizations to adopt and adapt to the second wave. In addition, governmental support to trade movements led to a surge in trade between organizations and the wave overlapped with the bullish markets in the 20s decade (Moeller and Brady, 2015). Vertical mergers gained preference over horizontal – a stark contrast to the first wave. The second wave closed with the onset of the Great Depression; triggered by the market collapse of 1929. It led to the Securities and Exchange Commission getting established in 1930. The second wave still primarily featured large industrial sectors, including chemicals, petroleum, and food (Galloway, 2017).

The third wave began in the 1960s and continued for nearly a decade, but the years between 1965 and 1969 were particularly robust with activity (Lebedev, et al, 2015). In this phase, conglomerate mergers were rather popular because businesses were particularly taken by the idea of diversification, thus they acquired companies which belonged in other business categories. Due to this, the third wave was historically labeled as the age of conglomerate mergers. Also, it is not surprising that the third wave was dominated by conglomerate mergers (Lebedev, et al, 2015). The first and second wave respectively witnessed horizontal mergers versus vertical ones (which were very few.) Due to the types of mergers which materialized in the first wave, the Sherman Act was implemented in response to them; an effort to stop market monopoly (Galloway, 2017).

Due to new laws being imposed, corporations therefore acted decisively and opted for vertical mergers. This bold step resulted in a transformation; vertical mergers encompassed all levels of the production pyramid, and also assumed control of the distribution networks (Galloway, 2017). This new trend of vertical mergers created a dire need for a new law to come into effect. Consequently, the Celler-Kefauver legislation act was announced in 1950 – a strong extension and follow-up to the Clayton Antitrust Act (Whitaker, 2016). This legislation forbids business organizations from overtaking control of production activities and distribution channels. In the wake of new legal implications, business corporations started veering in the direction of conglomerate mergers (Whitaker, 2016). This new merger-type opened up another window of expansion opportunity. It stimulated growth and profits escalated. By the time the third wave end, profitability became reduced, performance levels dropped, as companies grew in size. Reflecting on the movements that took place in the third wave, it is clear that at first companies favored horizontal expansion then migrated to vertical integration, and then by rule of Law, companies got pushed to adopt conglomerate mergers (Whitaker, 2016). However, the trends may have changed, all of the merger-types have shown that they are restricted – in one way or another – and expansion possibilities via mergers grew further limited in this wave (Whitaker, 2016). Furthermore, enactment of a new legislative act titled Hart-Scott Act, in 1973, exerted more definitive control on merger activities in the US (Poli, 2015).

By the time the fourth wave happened, the frequency of mergers augmented significantly (Yaghoubi, et al, 2016). So much so, that the wave has been given the moniker "merger-mania wave." This wave is a clear departure from the previous three waves; the primary differentiating attributes of this wave are the increased size and reputation of the merger targets (Yaghoubi, et al, 2016). Besides, the mergers in the fourth wave were governed by a hostile model, caused due to companies and managements' failure to reach a mutual agreement (Sherman, 2018). Instead, the deal closed by directly reaching out to the stakeholders of the target company with the motive to replace the management and get an approval for the merger to get materialized. Resultantly, the fourth wave's dominant trait is the hostile takeovers/mergers (Sherman, 2018).

As merger activities in this wave took place rather profusely, it came to be known as "megamergers" as well. The acceleration in the number of mergers was mainly due to Japanese and European investors were turned to the US corporate sector, and sought to invest in the

organizations as they were relatively cheap then. The scenario emerged due because the value of the Dollar has suffered a setback in markets, the growth of Japanese bonds in the market gave the Japanese leverage to explore debt-possibilities. In these phase, mergers were mainly being signed by companies in the oil and gas sectors, while pharmaceuticals, airlines and banking forging a new trail of opportunities for those in the investments sector having adopted serious roles by transforming into risk-free advisory services. The years which followed, witnessed a downfall in the reliability ratings of the Japanese bonds market, and dangers of high interest rates made many corporations become debt-ridden. Companies filed for bankruptcy, and the end of the wave was marked by the introduction of outsourcing concept.

The unique characteristic of the Fifth Wave was that it was not just limited to the United States (Rani, et al, 2016). This wave, due to markets getting globalized and increasing market competition, became widespread internationally. The wave was afoot in 1993 when the economy began to bounce back from the recessive period of 1990-1991 (Rani, et al, 2016). As the economy began to expand, corporations looked for ways to cater to the rising demand. The fifth wave is called as the most mature and transformative phase of mergers (Rani, et al, 2016). The metamorphosis of mergers in the wave is credited to the global markets', creation of the European Union bloc, and consequently the disappearance of nationalistic limitations as the continent moved towards a one-market policy and adoption of a common currency – the Euro. Majority of the mergers in this phase happened in sectors of banking, automobiles, airlines, petroleum and gas, and Internet companies (Rani, et al, 2016).

The Sixth wave occurred between 2003 and 2007. It was characterized by trends of globalization, shareholder activism, and privatization (Bodolica and Spraggon, 2015). The wave unfolded rather close to the time when the world was recovering from the dotcom collapse. At this juncture, shareholder participation intensified, and therefore the shareholder activism concept and trend became a new normal. Exercising their ownership rights, shareholders assumed more authority and control in corporations' actions and activities (Bodolica and Spraggon, 2015). Although shareholders did not directly run the corporations, but still, they became actors in the decision-making processes.

Due to the increased role and participation of shareholders in organizational activities, private equity also came into the fold, and privatization gathered pace thus (Morresi and Pezzi, 2014).

Another byproduct was the Leveraged Buy-outs (LBOs) gained prominence and became widespread (Morresi and Pezzi, 2014). Leveraged Buy-outs (LBOs) are defined as mergers or acquisitions wherein the acquirer has to obtain loans in order to fulfill the costs of the target company, enabling them to materialize mergers and acquisitions without having to invest large capital. This form of mergers and acquisitions were not observed since the Fourth Wave (Graz and Papajorgji, 2015). However, in the sixth Wave, LBOs took place at minimized interest rates and private equity businesses were willing to play a role in the process (Morresi and Pezzi, 2014).

At this point, globalization emerged as the critical factor driving majority of the mergers and acquisitions (Malik, et al, 2014). Large firms – even the well-established ones – were adamant about their expansion plans; making their companies more globalized. The cross-border merger trend continued to grow significantly in the sixth wave, and the benefits were far greater than they were in the Fifth wave. The trend was further helped by availability of government support and private equity funds (Malik, et al, 2014). But, the wave came to an abrupt close in December 2007 when the subprime mortgage crisis sparked an economic collapse in the US. The same pushed the country into recession.

After the US real estate market collapse, the Seventh wave of mergers did not come about until 2011 (Vazirani, 2015). The BRICS bloc led the reemergence of mergers in world markets. BRICS is a conglomerate of nations comprising Brazil, Russia, India, China, and South Africa. These are five economies that are rapidly-growing (Vazirani, 2015). The countries are readily developing or have recently been witnessing heightened industrialization. These countries are also amongst the most-populated in the world – they accounted for almost 40 percent of the world population, according to 2015 statistics (Vazirani, 2015). BRICS is pushing for increased trade corporation, and thus it is not surprising that these countries have become the crux of merger-activity (Vazirani, 2015).

1.2.2 Merger Trends in GCC Countries

Well-aware of how mergers and acquisitions help the cause of business growth and economic acceleration, GCC states have shunned away reluctance and warmed up to the concept in the recent years. This is reflected in the numbers. In 2006, 197 mergers and acquisitions materialized

in the GCC; transactions amassing $23 billion. The numbers rose to 423 mergers and $40 billion in 2015 (Mahmoud, 2016).

In the GCC region, mergers are still motivated by domestic transactions and organic progression, as cross-border deals continue to gather prominence – as most deals in the GCC are mainly cross-border mergers (Mahmoud, 2016). Faced by unique economic and geopolitical challenges, the need for power consolidation is gaining traction rapidly. Plagued by low oil prices, GCC banks are witnessing low profitability in terms of liquidity caused due to cutbacks in federal oil deposits and rising defaults (Mahmoud, 2016).

In recent years, this trend has grown promising in the wake of domestic consolidation. An example of such an integration materialized when two listed banking establishments - First Gulf Bank and the National Bank of Abu Dhabi – signed a merger deal worth $14.8 billion, in 2016 (Mahmoud, 2016). Another significant merger took place between IPIC and Mubadala Development Company (also combining both their assets). Formalization of the merger in law was achieved through the formation of the Mubadala Investment Company, which was poised to become one of the key investment sources for the emirate of Abu Dhabi. This led to the creation of a sovereign wealth fund worth $125 billion – one of the largest in the world (Mahmoud, 2016).

Domestic investors and corporations in the GCC are rather attracted to the idea of examining expansion opportunities through cross-border deals (Mahmoud, 2016). In 2016, a good precedent was set by Emaar – one of UAE's largest investor groups – that showed interest in buying the Kuwait Food Company (also well-known as Americana.) Eventually, the agreement happened, and Emaar brought the company for $3.05 billion (Mahmoud, 2016).

The banking sector has seen considerable success in terms of mergers. However, specifically in UAE's context, it is not as though the banking sector is all-welcoming about merger activities. Despite the fact that UAE presents itself as a massive market for banking mergers, there are challenges galore. Firstly, UAE is an active member of the World Trade Organization (WTO). The membership makes it mandatory for UAE to open wide its banking industry (Al-Karasneh and Fatheldin, 2005). Majority of UAE banks are still small in scale and inadequate in terms of management operations. Moreover, it is routine for most UAE banks to receive preferential

treatment from the federal authorities, and a handful of banks are co-owned by the ruling family or cabinet ministers (Al-Karasneh and Fatheldin, 2005). There is an urgent need for UAE to upgrade its banking management and operations else it would be an uphill task for domestic banks to stay afloat if and when UAE markets are opened. Also, UAE's local banks are challenged by the weak financial strength ratings from Moody's International. The banks' ratings are between 'C' and 'D-' – which is a far cry from the 'Aaa', 'Aa' or 'A' ratings given to international banks (Al-Karasneh and Fatheldin, 2005). Other than regional political instability and absence of reporting transparency in UAE banks, it is the incompetency in terms of organization size, and management, other than poor decision-making frameworks for mergers' are among the chief problems that need to be addressed in UAE's banking sector.

1.3 Problem Statement

In the UAE, merging decisions been made on various sectors to be merged on banking and governments. Mergers include Department of Municipal Affairs merger with Department of Transport for 6 months and then they split again, where AbuDhabi Urban Planning Council merged with Department of Municipal Affairs after splitting from Department of Transport. Other such mergers include the National Bank of Abu Dhabi and the First Gulf Bank and Mubadala merged with International Investment Petroleum Company. Within the governance policy, the federal bank has failed to establish a framework for managing the mergers. This has created problem in the merging decision within the UAE. One instance is the merger between the National Bank of Abu Dhabi and the First Gulf Bank created the biggest financial entity with over $183bn. The new bank has significant impact on the decision making process with the government owning approximately 37% of the merged entity. The framework is designed to be a reference based for any merging decision with the aim of minimizing the risk and the maximization of profit within the organization.

1.4 Aim

The aim of the research is

'To propose a framework that can be adopted on banking and public sectors to support and manage the decision regarding merging in strategic context.'

1.5 Objectives

To achieve the research aims in the study, the following set objectives were developed

- To examine and evaluate comprehensively the decisions regards merging in the area of managing merges, strategic strategy behind merging, challenges, and barriers.
- To identify supporting theories for building a conceptual framework.
- To investigate empirically the influential factors that can support the decisions regards merging in banking organizations.
- To develop a framework, within the practical arena, and provide a novel contribution to the domain of merging and strategic steps for merging.

1.6 Research Questions

To facilitate the achievement of the research objectives the following questions have been proposed:

RQ1: How are decisions made to adopt and implement merging in banking organisations?

- How are decisions made to adopt and implement merging in banking organisations?
- What are the best practices to be adopted for successful merging?
- What are the strategic actions, steps, and best practices to be acquired for successful merging?
- What are the challenges and barriers facing merging decisions?

RQ2: How are the consequences behind merging?

- What are the impacts of the users and on market competitions?

RQ3: How merging will help on supporting strategy planning and future accelerations?

1.7 Summary and Conclusion

In this chapter, the researcher has pitched a background to the study of mergers and their implementation in the context of the UAE's banking sector. The scope of research has been the public and private banks in the UAE. The researcher presents the rationale that governs the motivation of this research, having identified the problem areas (mainly lack of proper decision-making framework.) This is followed by giving a historical overview of mergers and acquisitions – and how they have evolved in form and application through various periods of history, and in the modern-day. Further to this, light has been shed on the growth and transformation of merger trends in the GCC.

This research study argues although UAE's government and bank sector are well aware of the advantages of mergers, still the implementation of mergers in the UAE is lackluster and not as very widespread. This is mainly because there is an unavailability of a viable decision-making framework, and it escalates the challenges and obstacles the sector has to face when trying to make mergers materialize. Therefore, the following research study endure to put forth a developed analytical framework that the banking institutions and public sectors can espouse, to provide support and manage merger-related decisions in the UAE. This chapter establishes the aim and objectives as well as the research questions to be tackled.