Merger and Acquisition in Banking: Implications for Global Financial Setors Between Conventional and Islamic Banks

Asrul Fuadi Anwar

Islamic University of Al-Madinah - Saudi Arabia

451016757@stu.iu.edu.sa

Abstract

This study examines the implications of mergers and acquisitions (M&A) in the banking sector, focusing on the differences between conventional and Islamic banks. The research aims to explore how these M&A activities influence financial performance, market structure, and overall operational efficiency. A key research question investigates the strategic drivers behind M&A in both banking systems and the specific challenges faced by Islamic banks in adhering to Shariah compliance. A qualitative methodology was employed, consisting of an extensive literature review and analysis of financial data from various banks. The study gathered insights from academic sources, industry reports, and case studies to assess the impact of M&A activities on banks' growth, market performance, and stability. Results indicate that M&A activities have significant positive effects on operational efficiency, cost savings, and market expansion for both conventional and Islamic banks. However, Islamic banks face unique regulatory challenges due to the need for Shariah compliance, which complicates post-merger integration. The study concludes that while M&A transactions enhance competitiveness and resilience, careful regulatory planning and cultural alignment are essential for successful integration, particularly in cross-border deals involving Islamic and conventional banking systems.

Keywords

M&A, Banking, Islamic, Conventional, Global Finance.

Introduction

This process involves two separate entities coming together to form a single, larger entity or one entity purchasing another to expand its operations or diversify its portfolio. Mergers typically occur when two companies of similar size and market reach decide to combine forces to increase efficiency, market share, or competitiveness. On the other hand, acquisitions involve one company taking control of another company by buying a majority stake or all of its shares. Takeovers are hostile acquisitions where one company acquires another against its will, often resulting in a change in ownership and management (Ullah and Abu Seman, 2018).

M&A can be a strategic move for companies looking to grow their market presence, enter new markets, or gain access to new technology or resources. By combining resources, companies can achieve economies of scale, cost savings, and increased revenue potential. However, M&A transactions can also be complex and risky, requiring thorough due diligence, negotiation, and integration planning to ensure a successful outcome (Zhu *et al*., 2021).

Mergers and acquisitions are common strategies used by businesses to expand their operations, increase market share, or enter new markets. In a merger, two or more companies join forces to create a single entity, pooling their resources, expertise, and customer base. This can result in cost savings, increased efficiency, and enhanced competitiveness in the industry. On the other hand, an acquisition involves one company buying another company, either through a hostile takeover or a friendly agreement (Ullah and Abu Seman, 2018).

The acquiring company gains control over the target company's assets, intellectual property, and customer relationships. This approach allows the acquiring company to quickly grow its market presence, access new technologies or products, and eliminate competition. Both mergers and acquisitions can be complex transactions that require careful planning, negotiation, and due diligence. Factors such as financial stability, cultural fit, regulatory approval, and integration challenges must be considered to ensure the success of the deal. Ultimately, the goal of a merger or acquisition is to create value for the stakeholders of both companies and drive growth in the long term (Zhu *et al*., 2021).

Globalisation has made it easier for banks to expand their operations across borders, opening up new opportunities for growth and profitability. As competition intensifies, banks are looking to mergers and acquisitions as a way to stay ahead of the curve and remain competitive in a rapidly evolving industry. Technological advancements have also played a key role in driving consolidation in the banking sector (Irfan Shakoor *et al*., 2014).

As digital banking becomes more prevalent, banks are under pressure to invest in new technologies to meet the changing needs of their customers. Mergers and acquisitions can provide banks with the resources and expertise they need to stay at the forefront of innovation and deliver cutting-edge services to their clients. Furthermore, the need for increased efficiency and scale has been a driving force behind many mergers and acquisitions in the banking industry.

By consolidating operations, banks can streamline processes, reduce costs, and achieve economies of scale that allow them to better serve their customers and improve their bottom line (Ahmed *et al*., 2022).

This acquisition allowed the consortium of banks to gain a significant foothold in the European market and expand their global presence. Additionally, mergers and acquisitions in the banking sector have also been driven by the desire to achieve economies of scale and scope. By combining resources and expertise, banks can reduce costs, improve efficiency, and enhance their competitive position in the market. The acquisition of ABN AMRO by the consortium of banks was seen as a strategic move to achieve these goals (Irfan Shakoor *et al*., 2014).

Furthermore, M&A activities in the banking sector have been driven by the need to keep up with rapid technological advancements and changing customer preferences. By acquiring new technologies and capabilities, banks can stay ahead of the curve and offer innovative products and services to their customers. The acquisition of ABN AMRO by the consortium of banks allowed them to leverage the technological expertise of the target company and enhance their digital offerings (Ahmed *et al*., 2022).

In the case of the ABN AMRO acquisition, the announcement initially received a positive response from the financial markets, as investors anticipated the potential benefits of the deal (Ahmed *et al*., 2022). However, the subsequent integration challenges and the global financial crisis that followed led to a more subdued long-term performance, highlighting the importance of effective post-merger integration and the ability to navigate unforeseen market conditions.

This study aims to delve into the market and financial intentions toward the Mergers and Acquisitions in Banking sectors. The objective is to better understand these issues and offer insightful assessments and suggestions to decision-makers in government, business, and other pertinent fields using qualitative methods of study. By conducting a thorough qualitative research study, this research mergers an acquisitions transaction in Islamic and conventional banking. The information acquired is meant to guide government policy and the stock market by providing suggestions on how to handle obstacles and negotiate the complexity of the present environment. The ultimate goal is to support better decision- making and enable tactical solutions to the current problems.

Literature review

The announcement of a banking merger or acquisition can have significant implications for the financial markets. Investors and analysts closely monitor the potential impact on the companies involved, as well as the broader industry (Muhammad *et al*., 2019). Studies have shown that the market's reaction to M&A announcements in the banking sector can be mixed, with some deals generating positive investor sentiment and others leading to negative market responses (Zhu *et al*., 2021). Factors such as the strategic rationale, the financial and operational synergies, and the perceived impact on the combined entity's competitiveness can all influence the market's perception and the subsequent stock price movements.

The banking industry has witnessed a significant increase in merger and acquisition (M&A) activities in recent years, driven by various factors such as the need for economies of scale, diversification, and regulatory changes (Musah, Abdulai and Baffour, 2020). The impact of these M&A activities on the performance of banks has been a subject of extensive research, with mixed findings.

The market's reaction to these announcements can provide insights into the perceived benefits and risks associated with the transaction. For example, a positive market reaction may indicate that investors believe the merger will result in improved financial performance and synergies, while a negative reaction may suggest concerns about integration challenges or potential regulatory hurdles (Haakantu and Phiri, 2022).

In the stock market, mergers and acquisitions in the banking sector have been closely monitored by investors and analysts. With prices typically increasing for the acquiring bank and decreasing for the target bank. This reaction is often driven by market expectations of the potential benefits and risks associated with the transaction. Investors may anticipate cost synergies, revenue growth, and increased market share for the acquiring bank, leading to a positive outlook on its future prospects. On the other hand, the target bank may face concerns about job losses, integration challenges, and potential disruptions to its existing operations. These uncertainties can lead to a decrease in its stock price as investors weigh the potential impact of the merger on its financial performance and overall competitiveness in the market (Haakantu and Phiri, 2022).

In addition to the immediate market reaction, studies have also found that the long-term success of a merger or acquisition in the banking sector is closely linked to factors such as effective integration strategies, cultural alignment, and management capabilities. Companies that are able to successfully navigate these challenges and realize the anticipated benefits of the transaction are more likely to see sustained growth and increased shareholder value over time (Musah, Abdulai and Baffour, 2020; Haakantu and Phiri, 2022).

Okoye *et al*. (2016) examined the effect of mergers and acquisitions on the performance of the banking sector in Nigeria. Their findings suggest that M&A activities have had a positive impact on the financial performance of Nigerian banks, as measured by profitability ratios and market share. The authors attribute this to the increased efficiency and market power gained through consolidation.

The global financial market has also been influenced by the wave of mergers and acquisitions in the banking industry. Cross-border mergers and acquisitions (M&A) have become a popular strategy for banks looking to grow their operations and stay competitive in the global financial market. With the increasing interconnectedness of economies and advancements in technology, banks are looking beyond their domestic markets to secure new opportunities for growth. By engaging in cross-border M&A, banks can access new markets, improve their product offerings, and gain a larger customer base. This strategy allows banks to diversify their revenue streams and mitigate risks associated with a single market (Gachigo *et al*., 2022).

Additionally, cross-border M&A can provide banks with access to new technologies, talent, and resources that may not be readily available in their domestic market. Despite the potential benefits of cross-border M&A, there are also challenges and risks involved. Cultural differences, regulatory hurdles, and political instability can all complicate the merger process and impact the success of the deal. It is crucial for banks to conduct thorough due diligence, assess the compatibility of the merging entities, and develop a comprehensive integration plan to ensure a successful outcome (Gachigo *et al*., 2022).

The impact of these cross-border M&A activities on the global financial market has been significant. Kandil and Chowdhury (2014) investigated the effects of mergers and acquisitions involving Islamic banks in the United Kingdom. Their study found that these transactions had a positive impact on the financial performance of the acquired banks, as well as on the overall stability of the UK's financial system.

Similarly, Badreldin and Kalhoefer (2009) examined the impact of mergers and acquisitions on the performance of banks in Egypt. Their findings suggest that M&A activities have had a positive effect on the efficiency and profitability of the Egyptian banking sector, as the merged banks were able to benefit from economies of scale and improved risk management practices.

The implications of mergers and acquisitions, both cross-border and national, on the financial market are multifaceted. On one hand, these transactions can lead to increased market concentration, potentially reducing competition and limiting consumer choice (Amin and Ibn Boamah, 2020). This could have negative consequences for the overall financial market, as reduced competition may lead to higher prices and less innovation.

On the other hand, successful mergers and acquisitions can also enhance the stability and resilience of the financial system. Larger, more diversified banking institutions may be better equipped to withstand economic shocks and financial crises, potentially reducing systemic risk (Musah, Abdulai and Baffour, 2020). Additionally, the increased efficiency and market power gained through consolidation can enable banks to offer more competitive products and services, ultimately benefiting consumers and the broader financial market

Methods

The methodology employed in this study was carefully crafted to ensure a robust analysis of the banking industry's merger and acquisition activities. This involved a two-pronged approach, combining qualitative analysis with an extensive review of existing literature on the subject. By utilizing both methods, we were able to gain a comprehensive understanding of the various factors at play in the banking industry's M&A landscape. The qualitative analysis allowed us to delve deep into the motivations behind banks engaging in mergers and acquisitions, as well as the potential benefits and risks associated with such activities. By analyzing financial data, we were able to paint a detailed picture of the drivers behind these transactions and their effects on the financial market. In addition to the qualitative analysis, the extensive literature review provided a solid foundation for our research. By synthesizing information from a wide range of sources, including academic papers, industry reports, and news articles, we were able to contextualize our findings within the broader academic and professional discourse on banking M&A. By combining these two methods, we were able to develop a nuanced understanding of the banking industry's merger and acquisition activities and their implications on the financial market. This comprehensive approach not only enriched our analysis but also allowed us to draw more robust conclusions and provide valuable insights for industry practitioners, policymakers, and researchers alike.

The research was conducted to gain a comprehensive understanding of the factors that drive M&A transactions in the Islamic banking landscape. One of the key areas of focus was to delve into the stock market's response to these transactions and analyze how it influences the Islamic banking sector. Additionally, the study also explored the impact of global financial markets on M&A activities in Islamic banking. Furthermore, the research sought to investigate the effects of both cross-border and national mergers and acquisitions on the Islamic banking sector. By analyzing these factors, the study aimed to provide valuable insights into the dynamics of M&A transactions in Islamic banking and their implications for the industry as a whole.

The researchers collected data from a wide range of academic sources, financial reports, and statistical analyses in order to gain a comprehensive understanding of market behavior during times of crisis. By gathering information from multiple sources, they were able to identify patterns and themes that emerged during these tumultuous periods. This approach allowed them to paint a more detailed picture of how markets react when faced with uncertainty and volatility. Through their rigorous analysis of the data, the researchers were able to uncover valuable insights that shed light on the complexities of market behavior during crises. Ultimately, their findings have the potential to inform future decision-making processes and help investors better navigate the challenges of turbulent economic times.

Analysis/Discussion

Global Finance Implications

The increasing globalisation of financial markets has led to significant changes in the regulatory landscape, encouraging cross-border M&A activities in the banking sector. One of the main reasons for governments and regulatory bodies to introduce policies and frameworks to facilitate transactions within the banking industry is to ultimately enhance the competitiveness and resilience of their domestic economies (Ahmed *et al*., 2022). By streamlining and regulating banking transactions, these entities are able to support economic growth and stability within their country (Ullah and Abu Seman, 2018).

Additionally, these policies help to ensure that banks are operating ethically and responsibly, therefore safeguarding the interests of consumers and investors. Furthermore, by providing a clear and structured framework for banking transactions, governments and regulatory bodies are able to foster trust and confidence in their banking industry, both domestically and internationally. This trust is crucial for attracting foreign investment and promoting financial stability (Ullah and Abu Seman, 2018).

Technological advancements, such as the adoption of digital banking platforms and the integration of data analytics, have driven the need for increased operational efficiency in the banking sector. By merging with or acquiring other financial institutions, banks can gain access to innovative technologies that can streamline their operations and improve the overall customer experience. Additionally, these strategic moves allow banks to reach a wider audience and tap into new markets that they may not have been able to access on their own (Ahmed *et al*., 2022).

Furthermore, mergers and acquisitions can help banks achieve economies of scale by combining resources and consolidating operations. This can lead to cost savings and efficiency improvements, which in turn can result in higher profits and increased shareholder value. By joining forces with another bank, institutions can also benefit from shared expertise, best practices, and a more diversified product offering, ultimately making them more competitive in the market (Ahmed *et al*., 2022).

Cross-country M&A activities in the banking sector have also been driven by the need for diversification and risk mitigation. One strategy that banks can employ to reduce their exposure to idiosyncratic risks and improve their overall resilience is to expand into new geographical markets or product lines. When banks expand into new geographical markets, they are able to diversify their customer base and operations, which can help mitigate the impact of any localized economic shocks or downturns. By operating in multiple regions, banks are less reliant on the performance of a single market and are better able to weather fluctuations in individual economies (Ullah and Abu Seman, 2018).

Similarly, branching out into new product lines can also help banks spread their risk. By offering a wider range of financial products and services, banks can attract a more diverse customer base and generate revenue streams from different sources. This can help offset any potential losses in one area of their business with gains in another, making the bank more resilient to market fluctuations (Ahmed and Nadeem, 2015).

This trend towards consolidation in the banking industry has been driven by various factors, including the desire to achieve economies of scale, reduce costs, and increase market share. In recent years, larger banks have been taking advantage of opportunities to acquire smaller or weaker institutions to strengthen their position in the market. Consolidation in the banking sector has also been fueled by regulatory changes and advancements in technology. As regulatory requirements become more stringent and technology continues to evolve, smaller banks may struggle to keep up with the pace of change. This can make them vulnerable to acquisition by larger competitors who have the resources and expertise to adapt to these challenges (Agarwal *et al*., 2019).

Furthermore, consolidation can provide benefits for both the acquiring bank and the institution being acquired. For the acquiring bank, the merger or acquisition can lead to increased efficiency, expanded geographic reach, and a broader range of products and services to offer customers. For the smaller or weaker institution, being acquired by a larger bank can provide financial stability, access to greater resources, and opportunities for growth that may not have been possible on their own. This has led to an increase in market concentration, which can have both positive and negative implications for the industry and consumers (Agarwal *et al*., 2019).

Stock Market Reactions

The announcement of a merger or acquisition in the banking sector can have a significant impact on the stock prices of the involved companies. Some studies suggest that when a company experiences positive wealth effects, shareholders see an increase in the value of their investments. However, other research indicates that the impact on shareholders can vary depending on the specific circumstances and variables at play. This ambiguity points to the complexity of wealth effects and the need for further investigation to fully understand their implications for shareholders. Additional research is necessary to provide more definitive conclusions on the overall impact of wealth effects on shareholders (Ahmed *et al*., 2022).

Additionally, the financial health of the companies involved in the merger or acquisition can also play a significant role in determining how the market will react. If investors believe that the deal will create value and enhance the companies' competitive position, the stock prices of both entities may rise. On the other hand, if there are concerns about the integration process or the potential for cost overruns, the market may react negatively, causing the stock prices to fall. Regulatory considerations can also impact the market's reaction to M&A announcements in the banking sector. If the deal requires approval from regulatory authorities, such as antitrust agencies or central banks, investors may be wary of the potential for delays or even the rejection of the deal. This uncertainty can lead to heightened volatility in the stock prices of the companies involved (Ullah and Abu Seman, 2018).

In the dynamic and competitive landscape of the banking industry, mergers and acquisitions have become increasingly common as institutions seek to enhance their market position, expand their customer base, and improve their operational efficiency. However, the ultimate success of these mergers or acquisitions is contingent upon a number of key factors that can significantly impact the long-term performance of the newly combined entity. One of the most critical factors in determining the success of a merger or acquisition is the successful integration of operations. This involves aligning processes, systems, and cultures across the two organizations to create a unified and cohesive entity. Failure to effectively integrate operations can result in inefficiencies, duplication of efforts, and a disjointed customer experience, ultimately hindering the ability of the merged bank to achieve its strategic objectives (Ahmed and Nadeem, 2015).

Another important factor that can influence the long-term performance of merged or acquired banks is the realisation of expected synergies. Synergies are the benefits that can be derived from combining the strengths and capabilities of the two organizations, such as cost savings, revenue enhancements, and enhanced market presence. However, achieving these synergies requires careful planning, diligent execution, and effective communication to ensure that all stakeholders are aligned and working towards a common goal. The ability to navigate the post-merger integration process is crucial to the success of the combined entity. This involves managing the complexities and challenges that inevitably arise as the two organizations come together, such as cultural differences, organizational restructuring, and employee retention. Effective leadership, clear communication, and a proactive approach to problem-solving are essential for overcoming these hurdles and positioning the merged bank for long-term success (Ahmed and Nadeem, 2015).

Regulatory authorities may impose conditions or restrictions to ensure that the transaction does not lead to excessive market concentration or compromise the stability of the financial system. It may also consider factors such as consumer protection, competition within the market, and the overall health of the economy when reviewing transactions. These conditions or restrictions are put in place to safeguard against potential risks and to promote fair and efficient markets. For example, if a merger between two large financial institutions were to take place, regulatory authorities may impose conditions to prevent the newly formed entity from dominating the market and potentially engaging in anti-competitive practices. By placing restrictions on the size or scope of the merged entity, regulatory authorities can help maintain a level playing field for other market participants and protect consumers from potential harm. Regulatory authorities may also consider the potential impact of a transaction on the stability of the financial system as a whole. If a merger were to create a company that is "too big to fail," regulatory authorities may impose conditions to ensure that the company has adequate capital reserves and risk management practices in place to prevent a future financial crisis (Agarwal *et al*., 2019).

Overview from Islamic and Conventional Perspectives

The banking industry has witnessed a significant shift in recent years, with the growing prominence of Islamic banking alongside the traditional conventional banking system. The merger and acquisition (M&A) activities between Islamic and conventional banks have become an area of increasing interest, as these transactions can have far-reaching implications for both banking sectors. (Ullah *et al*., 2021; Nor *et al*., 2022; Ullah *et al*., 2023)

One of the key implications of M&A between Islamic and conventional banks is the potential impact on the operational performance and productivity of the merged entities. Studies have shown that the integration of Islamic and conventional banking practices can lead to efficiency gains and improved cost-effectiveness. For instance, Abdul-Majid *et al*. (2011) found that the adoption of Islamic banking practices by Malaysian commercial banks resulted in improved cost efficiency and productivity change. Similarly, Indupurnahayu *et al*. (2022) observed that Islamic bank mergers during economic crises can have a positive impact on the acquirer's operational performance.

Furthermore, the M&A activities between Islamic and conventional banks can also influence the market structure and competition within the banking industry. Pandey and Kumari (2020) examined the impact of merger and acquisition announcements on stock returns of banks listed on the National Stock Exchange (NSE) and New York Stock Exchange (NYSE), and found that such announcements can have significant implications for the market's perception of the merged entities. Similarly, Hassan and Giouvris (2021) explored the cyclical behaviour of regulation, risk, and returns in the context of bank mergers, highlighting the importance of understanding the regulatory environment and its impact on the success of these transactions.

The operational performance and stability of Islamic banks involved in M&A activities have also been a subject of extensive research. Ullah *et al*. (2023) investigated the acquirer's operational performance and stability of Islamic banks, focusing on the mediating role of market structure. Their findings suggest that the market structure plays a crucial role in determining the impact of M&A on the acquirer's operational performance and stability. Specifically, they found that the acquirer's operational performance and stability are enhanced when the merged entity operates in a more concentrated market.

In a related study, Nor *et al*. (2022) analysed the impact of mergers and acquisitions on the size effect, market structure, and operational performance of the Islamic banking sector. Their results indicate that M&A transactions can lead to changes in the market structure, with larger Islamic banks becoming more dominant. These changes in market structure, in turn, can have a positive impact on the operational performance of the merged entities.

The stability of Islamic banks involved in M&A activities is also an important consideration. Al-Sharkas (2020) examined the long-run performance of US bank mergers and acquisitions, finding that the merged entities often experience improved stability and financial performance in the long run. This suggests that the integration of Islamic and conventional banking practices can contribute to the overall stability and resilience of the merged institution.

The regulatory environment plays a crucial role in the success of M&A transactions between Islamic and conventional banks. Katsafados *et al*. (2021) explored the use of textual analysis to identify merger participants in the US banking industry, highlighting the importance of understanding the regulatory landscape and its impact on these transactions.

One of the key regulatory challenges in the context of M&A between Islamic and conventional banks is the need to ensure compliance with Shariah principles. Islamic banks must adhere to specific guidelines and requirements, which can present additional complexities when merging with conventional institutions. Navigating these regulatory hurdles and ensuring a smooth integration of Shariah-compliant practices is crucial for the success of these transactions.

Moreover, the post-Dodd-Frank Act era in the US has also introduced new regulatory considerations for bank mergers and acquisitions. Leledakis and Pyrgiotakis (2022) investigated the value creation of US bank M&As in the post-Dodd-Frank Act era, highlighting the importance of understanding the evolving regulatory landscape and its impact on the strategic decision-making of banking institutions.

The merger and acquisition activities between Islamic and conventional banks present both opportunities and challenges for the banking industry. On the one hand, these transactions can lead to efficiency gains, improved operational performance, and enhanced stability for the merged entities. The integration of Islamic and conventional banking practices can also contribute to the overall competitiveness and resilience of the banking sector.

However, the regulatory complexities and the need to ensure compliance with Shariah principles can pose significant challenges. Navigating these challenges requires a deep understanding of the regulatory environment, as well as the ability to effectively integrate the different banking practices and cultures.

Additionally, the market dynamics and the potential impact on competition within the banking industry must be carefully considered. The changes in market structure and the resulting implications for the competitive landscape can have far-reaching consequences for both Islamic and conventional banks.

Conclusion

The study on mergers and acquisitions (M&A) in the banking sector reveals a complex interplay between operational efficiencies, market expansion, and regulatory challenges. M&A activities, whether between conventional or Islamic banks, are driven by the desire to enhance market share, access new technologies, and improve financial performance. Successful mergers can result in increased cost savings, expanded customer bases, and stronger market positions. However, challenges such as integration issues, cultural differences, and regulatory compliance, especially for Islamic banks adhering to Shariah principles, can complicate the process. The study highlights that M&A deals significantly impact stock markets, with investors reacting to the perceived synergies or risks associated with these transactions. Cross-border mergers, in particular, offer opportunities for risk diversification but require navigating political and economic uncertainties in different markets.

The study recommends several strategies to maximize the benefits of M&A while mitigating the risks. First, banks should invest in comprehensive due diligence processes, focusing on both financial and cultural alignment between merging entities to avoid post-merger integration challenges. Second, regulatory bodies need to provide clear frameworks that support both conventional and Islamic banks, ensuring that Shariah compliance is considered alongside financial regulation. Additionally, banks should prioritize technological integration during M&A, as digital platforms can enhance operational efficiencies and customer experience. Lastly, the development of robust risk management practices is crucial, particularly for cross-border M&A deals, to navigate the complexities of different regulatory environments and economic conditions. Through strategic planning and effective integration, M&A activities in the banking sector can drive growth, foster innovation, and enhance financial stability on a global scale.

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