

Fortune Favors the Bold: Evidence from an Emerging Market Bank Merger

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This study analyses one of the largest and controversial mergers from the Philippine Banking sector and links it to M&A theories: Firstly, this study survey prior M&A literature to identify merger motivations, synergies and factors affecting merger outcomes. Secondly, this study conducts a case study to link prior literature to a merger in an emerging economy. This merger provides an ideal setting for a case study, subsequent links to M&A theories and generalizable lessons for future bank mergers in emerging markets. Furthermore, this study identifies key factors and steps taken by the acquiring bank management to obtain success such as doubling net income, assets and becoming the number one bank in Philippines post-merger.

Keywords: mergers, acquisitions, synergies, cultural integration, banking

INTRODUCTION

Mergers and Acquisitions (M&A) are a key method for an organization to achieve growth, diversity, and profitability. Empirical research over the past couple of decades have revealed a great deal about M&A motives and factors affecting their outcomes. A profusion of prior literature identifies several motives behind M&A's and factors affecting M&A outcomes. However, there is a gap in the literature for emerging Asian economies which this study aims to fill. In addition, majority of prior studies demonstrate that M&A's result in value creation for the target firm shareholders. Given this setting, this paper will provide further evidence on these areas by surveying prior literature and developing a case study with a behavioral view point as well on an interesting yet controversial bank merger from Philippines. The study poses the following research questions: 1. What are the motivations and synergies associated with this particular merger? 2. What is the pre and post-merger performance of the banks involved? 3. What are the success factors for this particular merger? 4. What are the generalizable lessons and managerial implications from this case study? To the author's knowledge this is the first thorough case study on this particular bank merger.

This deal was selected due to its' implications on the Philippine (10th fastest growing economy) banking sector and generalizable lessons to other bank mergers especially in emerging economies. Moreover, majority of M&A deals involve the acquirer being considerably larger than the target or equal in size. However, in this particular setting, the deal was controversial since a smaller bank was attempting to acquire a considerably larger bank. The merger of the third largest bank, Equitable PCI with the fifth largest bank BDO in Philippines was initially perceived as hubris on the part of BDO management.

Several factors come into play especially with bank mergers. Firstly, the acquisition of a larger target by a smaller acquirer is rarely successful primarily due to the burden of financing. Secondly, economic

growth also becomes a key factor enabling the merged entity to grow and increase profits. Thirdly, bank mergers are notoriously difficult and expensive due to incompatibility of systems and integration of different corporate cultures. Fourthly, regulatory approval is required for bank mergers in many countries.

Moreover, one of the key questions that arise in bank mergers involve whether branch networks are complementary or overlapping? If they are complementary, similar to the case of the Wells Fargo's takeover of Wachovia or the merger of the Nordic banks to create Nordea, then the merger is likely to be easier. If they are overlapping, there is either going to be an unpleasant loss of jobs which will lower employee morale resulting in the combined entity being inefficient. Moreover, aggressive upward acquisitions can turn sour, for example, consider the HBO or RBS case.

The traditional recipe for success is that a strong acquirer buys the weak, when the targets' price is low such as Santander with Abbey, Alliance and Leicester. Shleifer & Vishny (2003), Rhodes-Kropf & Viswanathan (2004) support this view stating that overvalued firm managers acquire firms undervalued in scenarios where firm value diverge from the intrinsic value. Given this setting, the BDO and Equitable PCI bank merger is an interesting case with valuable lessons that can be generalized to other bank mergers especially in emerging bank-based economies.

Researchers and practitioners generally select a case study approach for M&A's especially when they intend to identify factors that impact an M&A deals success or failure. Haspeslagh & Jemison (1991), Shanley & Correa (1992) and Marks & Mirvis (1998) state that case studies are able to explore numerous aspects of M&A deals occurring in different environments subject to various influences. These influences are often found too difficult to be captured by alternative analysis techniques. In addition, the case study approach enables proper value creation analysis as compared to identifying events that create value. Haleblan et al, (2009) state that case studies are a powerful method considerably underutilized in M&A research where survey papers are more the common norm.

Moving onto the case study, at the time of BDO's initial offer to merge, Equitable PCI had capital three times as much as BDO. Analysts and regulators alike were concerned regarding the repercussions of this transaction on the Philippine banking sector and the economy. Moreover, the deal resulted in widespread negative media attention nationwide. Subsequently, the BDO merger with Equitable PCI was completed on December 27th, 2006 with the formation of BDO Uni bank.

The analysis is conducted both from a qualitative and quantitative perspective and provides evidence of value creation in M&A's. The analysis shows that even a deal with overvaluation issues in the short run would still result in value creation in the long run (refer Shliefer and Vishny 2003). The new entity BDO Uni Bank increased their net income from 3.1 million to 6.5 million relative to BDO on average. Moreover, BDO Uni bank doubled its total assets from 300 Pbn to 600 Pbn and became the number one bank in Philippines. In addition, this study provides interesting policy implications to the emerging market banking sectors and the M&A literature in general.

Section 2 conducts the literature review and deals with theories involved in M&A outcomes. Section 3 provides a detailed qualitative and quantitative analysis. Section 4 discusses generalizable lessons and managerial implications of the study. Section 5 concludes the study.

LITERATURE REVIEW

For over three decades, academics and practitioners alike sought to identify factors behind successful mergers. Prior academic literature documents the failure of M&A's to generate excess returns for the acquirer. Researches have also focused on understanding the main motivations for M&A's, value creation, and determinants of M&A returns. However, this study explores the prior literature with an aim towards differentiating between various views that affect M&A outcomes. This literature review section is segmented into three related areas: theories on M&A activity, motivations behind M&A deals and factors affecting M&A outcomes. In addition, refer to Berger, Demsetz, & Strahan (1999) and DeYoung, Evanoff & Molyneux (2009) for more detailed reviews of bank mergers. Table 1 summarizes the theories affecting M&A outcomes and links them to the findings from our case study.

TABLE 1
SUMMARY OF M&A THEORIES AND CASE STUDY FINDINGS

M&A Outcome Theories	Prior Literature	Our Case Study Findings
<i>Overvaluation:</i> M&A's occur in highly competitive markets resulting in prices being bid up to their intrinsic value	Sirower (1997), Haspeslagh & Jemison (1991), Kusewitt, (1985). Haspeslagh and Jemison (1991), Martin (2017)	Contradict overvaluation theory. Target was overvalued not the Acquirer.
<i>Agency Problems:</i> Agency issues in M&A's arise from agents involved in negotiating the transaction price of the deal	Kesner et al (1994), Lubatkin (1983), Schmidt & Fowler (1990), Kroll, et al (1997), Roll, 1986), Hayward & Hambrick (1997)	Support the Agency problem. Acquirer overpaid for the target.
<i>Management Factor:</i> The ability of the two management teams to work together such as complimentary management and prior experience in M&A's	Shanley and Correa (1992), Datta (1991), Walsh (1988), Krishnan, et al (1997), Singh and Zollo (1998), Schweiger et al. (1993), Jemison & Sitkin (1986), Larsson and Finkelstein (1999)	Support this theory as complimentary management was a key factor of the merger success.
<i>Employee Factor:</i> Job losses post-merger creating employee distress is a significant factor.	Haspeslagh and Jemison (1991), Galpin and Herndon (2000), Waddock & Graves (2006)	Support this theory as the merged firm was very forthright with employees about redundancies and the status of employees.
<i>Distinct Cultural Merger:</i> Focus on the cultural differences between the acquirer and target that needs to be reconciled and integrated post-merger.	Buono et al. (1985), Hofstede, Neuijen, Ohayv & Sanders (1990), Ivancevich et al (1987), Schweiger & DeNisi (1988), Nahavandi & Malekzadeh (1988), Chatterjee et al (1992), Cartwright & Cooper (1992), Forstmann (1998), Schweiger & Goulet (2005), Lodorfos & Boateng (2006), Mitleton (2006), Lin et. al. (2006), Saunders et. al. (2009), Mohibullah (2009), Melkonian, Monin, & Noorderhaven (2011), Xing & Liu (2016), Weber & Tarba (2012), Doseck (2012), Zaheer et. al. (2013), Rottig et. al. (2014), Syazliana et. al. (2015), Spoor & Mei-Tai (2017)	Support this theory in terms of the brand management and cultural integration done by hiring out side consultants by the merged firm.

Merger and Acquisition Theories

Widespread research on M&A activity has been conducted in the US and European markets. However, there is a dearth in research conducted on fast growing emerging markets, especially in Asia such as the Philippines. M&A's are an important tool for businesses and this section considers the history of M&A's. This study identifies the following benefits of M&A's from prior literature:

Economies of scale, entry to new markets, expansion of market share, new technology acquisition and surplus fund utilization. M&A activity generally occur in waves called merger waves and can be explained by neoclassical and market valuation theories. According to neoclassical theory, merger waves occur as a result of firms from different industries reacting to economic shocks, deregulation and new technologies. This explains the industry clustering of M&A activities. Gort (1969), Mitchell & Mulherin (1996) and Harford (2005) provide empirical support for this theory. Another theory suggests an association between merger waves and market valuations. According to Shleifer & Vishny (2003)'s market valuation theory of merger waves: Deviations from fundamental values result in managers using overvalued firm stock to acquire undervalued firm assets. Rhodes-Kropf, Robinson & Viswanathan (2005) also support the market overvaluation theory suggesting that more acquisitions occur during bubbles periods. The next section discusses motivations behind M&A's.

Merger Motivations

Why do companies opt for M&A's? Pfeffer (1972) states that M&A's are caused by a need to make a firm less dependent on its environment. Haunschild (1993) explains motivations for M&A's being associated with financial, resource dependence, managerial and agency theories. Capron & Hulland (1999) identify market power, efficiency and effectiveness as value creating factors in M&A's. Ahuja & Katila (2001) identify technological and non-technological factors as M&A motivations. They state that non-technological M&A motivations focus on getting access to a wider range of distribution channels while technological motivations focus on entry into new markets. Chang & Rosenzweig (2001) and Hayward (2002) associates M&A's with market related motivations such as entering, strengthening, expanding to new markets. In addition, synergy motivations for M&A's are identified by Golubov & Travlos (2012), Jensen & Ruback (1983); Bradley, Desai & Kim (1988); Seth (1990); Doukas & Travlos (1988); Wang & Xie (2009); Bris & Cabolis (2008); Scholes & Wolfson (1990); Hayn (1989); Manzon, Sharp & Travlos (1994); Houston, James & Ryngaert (2001); Hoberg & Phillips (2010).

Moreover, the following studies identify agency motivations behind M&A's: Amihud and Lev (1981); Lewellen, Loderer & Rosenfeld (1985); Jensen (1986); Harford (1999); Datta, Iskandar-Datta & Raman (2001); Masulis, Wang & Xie (2007); Lin, Officer & Zou (2011);

Finally, the following studies identify managerial overconfidence or CEO hubris behind M&A motivations: Roll (1986); Hayward & Hambrick (1997); Doukas & Petmezas (2007); Billett & Qian (2008); Malmendier & Tate (2008); Kolasinski & Li (2013). In addition, prior literature conclude that M&A's improve combined entity performance creating a competitive advantage (Lubatkin, 1983; Schweiger and Weber, 1989; Krug, Wright, and Kroll, 2013; Galpin and Herndon, 2014; Cunha, 2015; Sinclair and Keller, 2017). The next section discusses factors affecting M&A outcomes and theories involved.

Factors Influencing M&A Outcomes & Theories Involved

What factors affect M&A outcomes? Majority of prior literature show that M&A's are value destroying leading to productivity issues and inefficiencies. This section identifies five key factors that affect M&A outcomes: 1. Overvaluation; 2. Agency Problems; 3. Management Factor; 4. Employee Factor; 5. Cultural Merger;

1. *Overvaluation*: It is an implicit assumption that M&A's occur in highly competitive markets resulting in prices being bid up to their intrinsic value. Sirower (1997) urges top management to identify synergy gain extraction methods and the relevant strategies pre-merger. Prior literature warns management not to pursue overvalued M&A deals, especially if the price exceeds their own valuations (Haspeslagh & Jemison, 1991; Kusewitt, 1985). Haspeslagh and

Jemison (1991) report that management view inadequate due diligence processes result in sub optimal M&A outcomes. Martin (2017) finds that purchase prices exceeding that of market value maybe a cause for M&A failures.

2. *Agency Problems:* Agency issues in M&A's arise from agents involved in negotiating the transaction price of the deal. Kesner, et al, (1994) identify an agency problem between shareholder interests and that of the CEO during M&A's. In addition, Lubatkin (1983), Schmidt & Fowler (1990) state that CEO compensation increase relative to firm size. Kroll, et al (1997) find that management owned firms generate significant negative returns following a merger. Another stream of research considers CEO hubris as a key factor behind M&A failures (Roll, 1986). Hayward & Hambrick (1997) find that the premiums paid in M&A's signal the amount of value to be created post-merger by the acquirer. They find a significant relationship between CEO hubris and the premium size.
3. *Management Factor:* The ability of the two management teams to work together such as complimentary management and prior experience in M&A's are also important factors that may affect deal success. Shanley and Correa (1992) find that management teams of both firms agreeing on strategic objectives improve post deal performance. Datta (1991) find that managerial style differences in both firms can have a negative effect on post deal profitability. Walsh (1988) observe a significantly high turnover rate following an M&A within a five-year time window. Krishnan, et al (1997) observe that post deal performance is positively associated with complementary management teams and negatively associated with top management turnover at the target firm. Singh and Zollo (1998) provide evidence of a negative impact on deal performance from high turnover of target firms' top management in the US banking industry. Schweiger et al. (1993) show that intra firm differences are also associated with the deal outcome.

Experience of management on M&A's is also a key factor that affect M&A outcomes. Integrating two different entities into one is a key challenge faced by acquiring managers in M&A deals. Herein lies the importance of prior management experience in M&A's. Jemison & Sitkin (1986) state that success in M&A's is determined by extensive planning and proper post-merger integration. Singh and Zollo (1998) find that knowledge acquired in previous M&A deals positively impact performance in the banking industry. Larsson and Finkelstein (1999) identify a U-shape of the experience associated with M&A's.

4. *Employee Factor:* Job losses post-merger creating employee distress is also considered a significant factor affecting M&A outcomes. Subsequently, prior academics analyze the integration process post-merger and its impact on employees. Haspeslagh and Jemison (1991) find that M&A success also depends significantly on an encouraging and co-operative environment between the two merging firms. Galpin and Herndon (2000) state the significance of effective communication during M&A's. Waddock & Graves (2006) state that post-merger, the acquirer often impose their policies on the combined entity jeopardizing cultural integration and employee satisfaction.
5. *Distinct Cultural Merger:* This particular view focus on the cultural differences between the acquirer and target that needs to be reconciled and integrated post-merger. Post-merger integration of cultures also focus on the manner in which employees are assimilated into the combined firm. Similar to Buono et al. (1985)'s firm cultural conceptualizations, Hofstede, Neuijen, Ohayv & Sanders (1990) also find difficulties in changing firm culture. Given this setting, difficulty in cultural adaptability becomes reasonably prominent during the M&A process. In addition, Ivancevich et al (1987) and Schweiger & DeNisi (1988) emphasize the significance of sound communication during the M&A process. According to them, sound communication reduces confusion and uncertainty during the M&A process resulting in higher productivity, job satisfaction, turnover and lower absenteeism. Nahavandi & Malekzadeh (1988) find that agreement to the M&A deal by both acquirer and target management is a key factor of a successful merger. Chatterjee et al (1992) identify a

significant negative correlation among cultural differences of the target and acquirer management teams and excess stock returns. However, Cartwright & Cooper (1992) state that the key factor is the ability of the two firm employees to work together rather than the cultural differences of the two firms. Forstmann (1998) state that the post-merger integration process is a key factor in the M&A success. Schweiger & Goulet (2005) identify distinct cultures result in defensiveness and the maintenance of separate acquirer and target firm identities post-merger. Therefore, they state that elimination of cultural differences is key to successful integration and M&A success. Lodorfos & Boateng (2006), Mitleton (2006), Lin et. al. (2006) identify cultural diversity, employee treatment and communication as key factors in post-merger integration and success. Saunders et. al. (2009) state that sound communication and pre-merger audits of cultural differences are important steps to achieve proper successful cultural integration post-merger. Mohibullah (2009) state that the acquirer should implement a top down communication network among employees to decrease confusion during the M&A integration process. Melkonian, Monin, & Noorderhaven (2011) and Xing & Liu (2016) find that post-merger situations and integration issues influence employee identity on both sides of the M&A deal. Weber & Tarba (2012) state that a lack of transparent and congruent activities during various stages of the M&A process might lead to failures. Doseck (2012) discuss various aspects of firm culture, human resources and change management during the integration phase of M&As. Zaheer et. al. (2013) identify that management complementarity between the acquirer and target instead of similarity would lead to successful autonomy and integration post-merger. Rottig et. al. (2014) state that poor connections among the acquirer and target limit contributions in the M&A integration process. Syazliana et. al. (2015) identify early planning and cultural integration as being critical to M&A success in Malaysia. Spoor & Mei-Tai (2017) find that employee morale during an M&A deal is largely affected by social identities and communities of both firms involved.

DATA AND METHODOLOGY

Data is collected from secondary sources for this particular study. Archival records in the form of accounting and stock market data from the firms and Bloomberg are utilized. Data is also gathered from the Philippine stock exchange and central bank. In addition, various documents from newspaper articles and consulting reports are also perused. Data triangulation is conducted to establish converging lines of evidence to make findings more robust. Explanation building technique also involves exploring rival explanations from the data. In addition, a pattern-matching logic is implemented to compare empirically based pattern. Time-series analyses of ex ante ex post merger of the two banks on accounting and stock market data is conducted.

BDO Acquisition of Equitable PCI Bank (EPCIB): Case Study

Throughout history, Philippine banks' primary method of expansion has been through investments in M&A's and by establishing new branches. However, a key requirement for an M&A deal is shareholder value creation. In addition, according to prior literature the cultural fit and integration post-merger is an important factor as well, even when the M&A deal makes sense financially.

This section provides a case study analyzing one of the most important and interesting M&A deals from the Philippine banking sector. In 2005, BDO considered expanding its market share by acquiring Equitable PCI bank with a large number of established branches. Subsequently, BDO initiated talks with Equitable PCI Bank management to discuss the possibility of a friendly takeover. Following the successful merger, newly created entity BDO Uni bank at present holds the number one position in the Philippine banking industry.

Table 2 summarizes the target, acquirer, deal characteristics and reactions to the merger announcement.'

TABLE 2
SUMMARY OF ACQUIRER, TARGET, DEAL CHARACTERISTICS AND MERGER REACTIONS

Banks Involved	Ownership	Analyst Reaction to Merger Announcement	Deal Characteristics
<i>Target (Equitable PCI)</i>	<i>Pre-Merger Equitable PCI's key shareholders</i>	Standard & Poor's stated that a successful merger would result in an improvement in Equitable PCI's debt rating with no change in BDO's debt rating. Prior to the merger, Equitable PCI had a grade "B" debt rating while BDO had a "B+" rating.	BDO only bid for 43.50 PHP per share for SSS's 26% stake in Equitable PCI. Subsequently, they were offering 43.50 PHP per share or a 10% premium over the weighted average share price over a mutually agreed time period.
Equitable Banking Corporation" (EBC) was the former name of Equitable PCI bank (EPCI) when they opened on September 26 th , 1950.	Social Security System (SSS): 29%,	UBS claimed that Equitable PCI shareholders would realize the BDO offer attractive as it would increase Equitable PCI's capital adequacy ratio (CAR) making it a timely offer especially under new International Accounting Standards.	on August 5 th , 2005, BDO acquired a 24.76% stake of Equitable PCI. BDO and Equitable PCI board members agreed to a modified stock swap deal of 1.8 BDO shares instead of 1.6 shares for every Equitable PCI share on November 6 th .
In 1999, Equitable bank acquired PCI bank becoming the second largest bank in terms of assets.	Go Family: 24.76%,	UBS forecasted an increase in Equitable PCI share price to 73.60 PHP, more than the intrinsic target price of 67 PHP given the BDO offer.	BDO and Equitable PCI shareholders approved the transaction on December 27 th , 2006.
Prior to being acquired by BDO, Equitable PCI was the third largest domestic private bank with respect to loans, deposits and capital.	Government Service Insurance System (GSIS): 12.7%,	In 2006, many analysts downgraded their rating of Equitable PCI Bank to a "Sell" recommendation from "hold" following a 21% run-up pushed up its 2006 price to earnings ratio to 19.4 and its price to book value to 2.4, making it the most expensive banking stock in the Philippines.	

Banks Involved	Ownership	Analyst Reaction to Merger Announcement	Deal Characteristics
Offered innovative and also traditional deposit products, cash management, international, commercial, corporate banking, money market, trust and treasury services.	EBC Investments: 10.48%.	Regulator Reaction	
Catered to a wider base of retail and corporate clientele with an extensive distribution network.	Post Merger key shareholders	Equitable PCI was given till January 31 st to consider the deal.	
Acquirer (BDO)	SM Investments Corporation: 85.6%	GSIS initially opposed the deal and considered a counter proposal of a merger with BDO where Equitable PCI would be the surviving firm.	
BDO or commonly known as Banco De Oro was publicly listed on the Philippine Stock Exchange in 2002.	Trans Middle East Philippines Equities: 7.13%	Philippine central bank and the Securities Exchange Commissions' approval for the deal was obtained in early 2007.	
In 2001, BDO acquired 57 branches nationwide by merging with Dao Heng Philippines.	SM Investments Corporation: 40.87%.	Competition	
The following year BDO acquired 66 branches with 11 Pbn portfolio of deposits by merging with Banco Santander and Santander Investment Securities Philippines.		Foreign investors were also interested in Equitable PCI and submitted a bid of 90 PHP each for SSS shares; These Investor's identity was not made public.	

Banks Involved	Ownership	Analyst Reaction to Merger Announcement	Deal Characteristics
In 2004, BDO initiated proceedings to acquire the 26% stake of Equitable PCI bank from Social Security Systems (SSS). The Philippine government was in possession of the remaining 12% stake via Government Service Insurance System (GSIS).	In addition, BDO further increased their capital adequacy ratio from 2% to 3% by raising 10 Pbn of tier 2 capital; Following the merger, BDO Unibank[1] emerged as the top most bank with regard to assets, toppling Metropolitan Bank as of the end of 2008. Subsequently, the assets of BDO Unibank amounted to 808.04 Pbn, edging out Metrobank, with 758.48 Pbn of total assets.	GSIS stated that offers must be submitted by March 6 th to the bidding process for their shares at a minimum value of 92 PHP per share or higher.	
BDO ranked 5th, 6th and 8th with respect to resources and loans, deposits and capital respectively among the 41 commercial banks in Philippines as of December 2005.			

SM Investment Corporation: Henry Sys' Groups' premier bank, Banco de Oro or commonly known as BDO was interested in acquiring Equitable PCI (EPCI) since 2003. BDO subsequently announced intentions of acquiring 10% of EPCI's treasury stock. Equitable Card Network dominated the credit card industry in Philippines as a merchant acquirer and a third-party processor providing them ample motivation to increase their retail lending. PCI Capital Corporation was a popular name in investment banking and PCI leasing and Finance possessed a high capital base and a large clientele network. This acquisition of PCI bank by Equitable bank resulted in a merger wave in the Philippine banking sector. Not one to be left behind, BPI acquired Far East Bank targeting the number one position in banking and claiming it for a short time. Then, continued on a merging spree with Asian Bank, Solid Bank, Philippine Banking Corp and Global Bank to finally become the largest bank in Philippines. Hence, Equitable bank merging with PCI in 1999 resulted in a consolidation of the largely fragmented Philippine Banking Sector to some extent. Figure 1 shows the ownership structure of Equitable PCI bank pre-merger.

FIGURE 1
SHAREHOLDERS OF EQUITABLE PCI BANK (IN 2003)

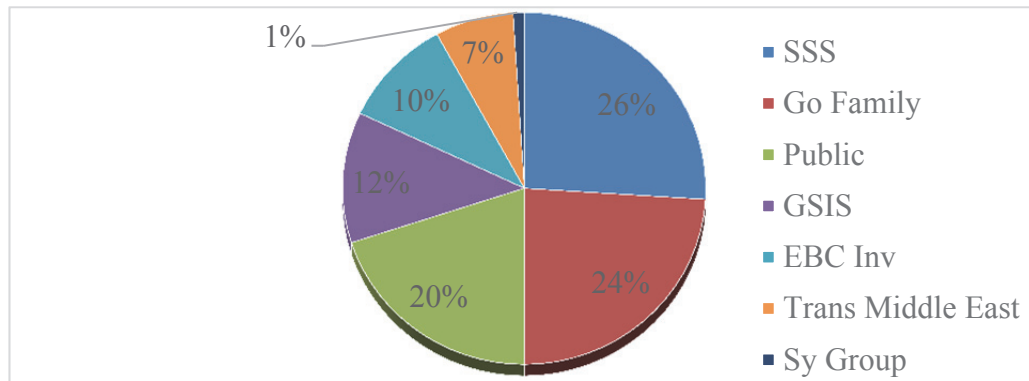


Table 4 summarizes the motivations of BDO, benefits to all stakeholders involved, merger synergies and success factors.

TABLE 3
SUMMARY OF MERGER MOTIVATIONS, SYNERGIES, BENEFITS AND SUCCESS FACTORS

BDO Motivation	Benefits	Merger Synergies	Success Factors
Belief of success by BDO top management (reassurance the merged entity can lead the banking sector; be bolder).	<i>BDO Stakeholders</i>	Complementary markets and clientele	Successfully integrated two distinct banking cultures.
Competitors (Defeat of a key competitor), vulnerability of other competitors such as Metro bank, future obstacles from other competitors).	Substantial revenue and cost synergies	Diverse products and services	Both management teams agreed upon the merger.
Expansion (increasing BDO franchise value). 4. Overvalued stock (Excess cash for acquisitions).	Dominant pro-forma market position	Complementary technologies & assets	Both management teams had prior experience in mergers.
Future vision	Enhanced distribution network	Diverse employee skill sets	Revenue synergies were readily identified and utilized.

BDO Motivation	Benefits	Merger Synergies	Success Factors
Wealth creation (Financial).	Improved balance sheet management	BDO gained a soundly established operation in prime fee generating departments such as trust banking, credit cards and remittances	Cost efficiencies were identified and efficiently utilized.
Legislative support (Deal was eventually supported by the Philippine central bank and the Securities and Exchange Commission).	Broader customer base and relationships (establishes scale, exposure to regional economic diversity and additional platform for growth).	Substantial profit enhancement was achieved through improved product and enhanced distribution network, greater investment in new products.	Improved balance sheet management.
	Market leading position in core business lines.	The combined entity took opportunities to increase revenues by cross selling the expanded product offerings and customer base as well as its affiliation with the SM Group network.	Affiliation of a large blockholder (SM group) provided better monitoring and a positive signal to the markets.
	Accretive to EPS (Accretive merger for BDO with Equitable PCI's strong predicted cash flows).		<i>Employee Engagement</i>
	Increased product diversification		BDO's President and senior leadership endorsed and led the employee engagement initiative
	Long term growth projects (Equitable PCI's profitable credit card business).		Human resources was segmented similar to customer segmentation by collaborating with key business and department heads to understand various needs and concerns of a diverse employee group
	Proven management teams (both management teams possessed valuable experience from past successful mergers, solid shareholder returns and cash flow generation).		Emphasizing on brand implementation through actionable behavior and linking the same actions to desired customer experiences

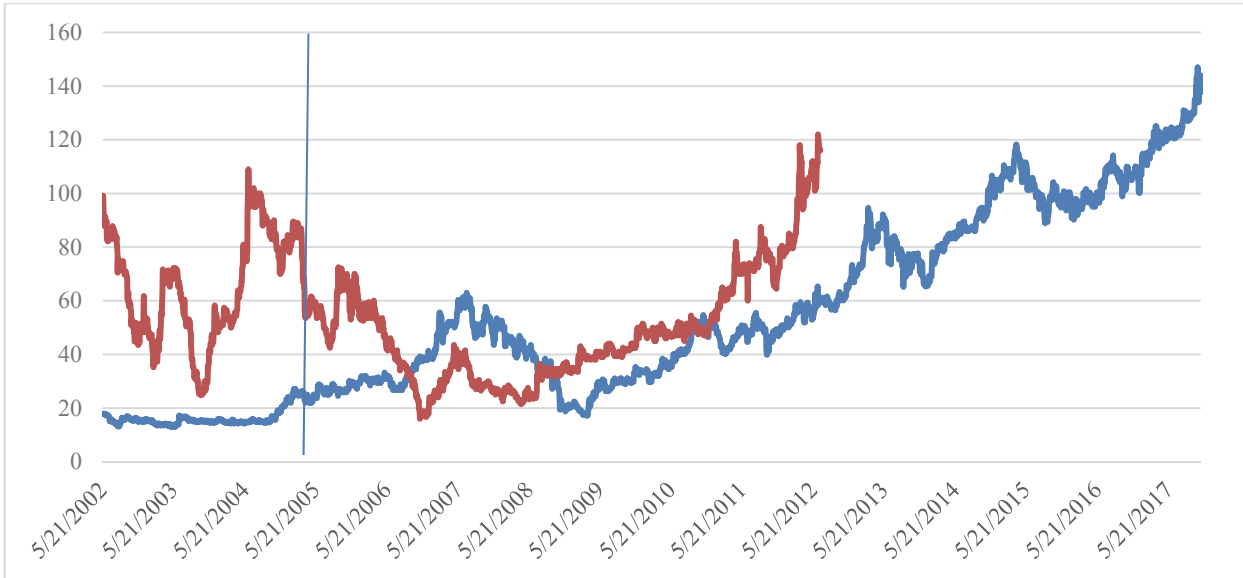
BDO Motivation	Benefits	Merger Synergies	Success Factors
	<i>Equitable PCI Stakeholders</i>		Piloting and promoting programs that demonstrated positive business impact of engagement
	Initially there was resistance from the Equitable PCI main shareholder GSIS, the rest of the Equitable PCI shareholders were swayed by the attractive acquisition price and future benefits from BDOs' dividend policy.		Creating and quickly implementing scalable solutions readily delivered through digital channels.
	Merger would provide a stronger platform to execute Equitable PCI's growth plans.		
	From Equitable PCI customers' point of view, the merger provided better access to a wider range of products and a better customer experience.		
	From Equitable PCI employees' point of view, the strong re-branding of the merged entity provided a strong cultural fit.		
	BDO completed the merger with Equitable PCI in 2007 and renamed itself as BDO Uni bank.		

Hence, given the above rationale, BDO justified this deal as a key strategic merger. Cost savings from the merger would arrive from overlaps and duplications from 120 branches. Revenue benefits would arise with size and scale, as the combined entity would rank No. 1 in all major sectors. The BDO offer implied a 2.3 times swap ratio. At the time of the initial offer from BDO, Equitable PCI management viewed the deal would be dilutive in the first two years and finally breaking even in the third year. In addition, the financing strategy for the deal was structured to maintain BDO's solid investment-grade credit rating. Moreover, market analysts reiterated that BDO is a top performer with a target price of 47 PHP. Hence, while the deal would be initially dilutive to BDO, this would outweigh the strategic transformation the deal would bring to the bank.

Empirical Analysis of the Merger

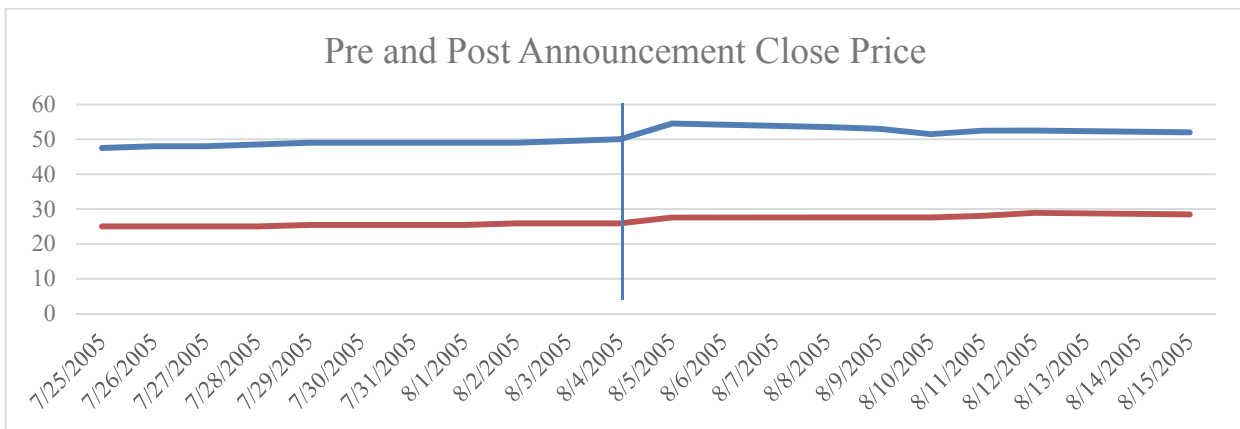
The merger between Equitable PCI bank (ranked 3rd) and BDO (ranked 5th) resulted in BDO Unibank (largest bank in Philippines). The tables and graphs provide empirical evidence pre and post-merger for both banks from financial statements, share prices, public and private information gathered from various parties involved in the merger. *Figures 2 and 3* shows the stock price reaction to the merger announcement and merger completion for both banks.

**FIGURE 2
HISTORICAL BDO AND PCI STOCK PRICE**



Note: The blue line depicts BDO close price and the red line depicts Equitable PCI stock price.

**FIGURE 3
PRE AND POST MERGER ANNOUNCEMENT EFFECT ON BDO AND EQUITABLE PCI
STOCK PRICE**



Note: The blue line depicts BDO close price and the red line depicts Equitable PCI stock price.

A correlation analysis was conducted on the total liabilities, total assets, and the revenue of BDO and Equitable PCI from 2003 to 2006. Total assets and liabilities have a significant positive correlation of 0.76 and 0.8 respectively. This result can be explained as both banks mirroring each other's behavior by expanding their assets and liabilities to obtain more market share as competitors. In addition, there is a negative significant correlation between revenues of the two banks identifying them as competitors. Moreover, this gives further support to BDO's motives of taking out a strong competitor and at the same time obtaining more market share by acquiring Equitable PCI.

TABLE 4
PHILIPPINE BANK RANKINGS WITH REGARD TO ASSET SIZE GIVEN IN PESO BILLION
EXCLUDING FOREIGN AND DEVELOPMENT BANKS, PRE MERGER IN 2004

	Rank	Assets	Rank	Loans	Rank	Deposits	Rank	Capital
Metro bank	1	470.6	1	243.7	1	345.7	2	53.4
BPI	2	394.8	2	162.2	2	314.7	1	55.0
Equitable PCI	3	293.5	3	134.2	3	189.6	3	44.4
PNB	4	220.2	5	78.4	4	163.5	4	24.0
BDO	5	169.8	6	69.9	5	121.4	6	19.6
RCBC	6	152.2	4	83.2	6	108.2	8	16.2
Allied Bank	7	118.5	8	47.2	7	92.7	9	15.4
China Bank	8	116.4	7	50.8	8	85.5	5	20.2
UCPB	9	104.9	9	46.5	9	79.4	17	4.1
Union Bank	10	100.3	10	39.1	10	56.6	7	16.6
Security	11	82.7	11	38.2	11	51.7	10	10.8

Source: Philippine Central Bank as of December 2004.

Table 4, shows that BDO had 304Pbn while Equitable PCI had 345 Pbn of total assets on December 2006. Post-merger total assets of BDO Unibank increased to 617 Pbn. Prior to the merger, Equitable PCI and BDOs' net loans were close to approx. 100 Pbn and expanded to 315 Pbn post-merger. Moreover, total liabilities and total deposits of Equitable PCI and BDOs' increased from 297 Pbn and 280 Pbn in 2006 to 556 Pbn in 2007 and from 229 Pbn and 241 Pbn to 445 Pbn in 2007 respectively.

TABLE 5
YEAR ON YEAR GROWTH OF THE TARGET (EQUITABLE PCI), ACQUIRER (BDO) AND
NEW ENTITY (BDO UNI BANK) BALANCE SHEET ANALYSIS, PRE AND POST-MERGER
IN PESO BILLION END OF THE YEAR

	2007	2006	2006
Balance Sheet	BDO Uni bank	BDO	Equitable PCI
<i>Assets</i>			
Net Loans	315.1	127.93	111.83
Total Assets	617.42	304.47	345.14
<i>Liabilities & Shareholder's Equity</i>			
Total Deposits	445.4	229.37	241.8
Total Liabilities	556.88	280.04	297.66

Source: BDO, Equitable PCI and BDO Uni bank financial statements.

Table 5, shows that Equitable PCI bank and BDO had net interest incomes of 13 Pbn and 8 Pbn, in 2006 which increased to 21 Pbn in 2007 post-merger. Moreover, Equitable PCI and BDO had a net income of 3.27 Pbn and 3.13 Pbn in 2006 December which post-merger increased to 6.52 Pbn. Therefore, Both Tables 4 and 5 show evidence of significant expansions in the income and balance sheet of BDO Unibank, resulting in value creation post-merger.

TABLE 6
YEAR ON YEAR GROWTH OF THE TARGET (EQUITABLE PCI), ACQUIRER (BDO) AND
NEW ENTITY (BDO UNI BANK) INCOME STATEMENT ANALYSIS, PRE AND POST-
MERGER IN PESO BILLION END OF THE YEAR

	2007	2006	2006
Income Statement	BDO Uni bank	BDO	Equitable PCI
Net Interest Income	21.49	8.33	13.12
Net Income	6.52	3.13	3.27

Source: BDO, Equitable PCI and BDO Uni bank financial statements.

TABLE 7
KEY RATIOS OF THE TARGET (EQUITABLE PCI), ACQUIRER (BDO) AND NEW ENTITY
(BDO UNI BANK) PRE AND POST-MERGER END OF THE YEAR

	2007	2006	2006
Profitability %	BDO Uni bank	BDO	Equitable PCI
NIM	4.0	3.3	4.3
ROA	1.41	1.16	0.17
Diluted EPS	2.56	2.89	4.88
BV per share	23.45	22.91	63.7

Source: BDO, Equitable PCI and BDO Uni bank financial statements.

Table 6 show several key ratios of BDO, Equitable PCI and BDO Uni bank post-merger. In December 2006, Equitable PCI had a net interest margin of 4.3%, while BDO's was 3.3% which settled at 4% post-merger. Implied interest payments are a key component in the Net Interest Margin (NIM) calculation. In the case of BDO and Equitable PCI bank, implicit interest payment effects on NIM showed signs of concentration following the consolidation period due to changes in combined entity operations and revenue structure. Equitable PCI bank and BDOs' return on assets of 0.18% and 1.16% in 2006 increased to 1.41% in 2007 for the combined entity BDO Uni bank. Return on assets (ROA) measure effectiveness of the firm's assets utilization in generating profits net of expenses. Hence, these results show improved ROA numbers possibly due to new combined entity better managing its assets to generate profits.

Moreover, BDO Uni bank enjoyed a larger client base and an increase in number of offices and branches widely dispersed across the Philippines post-merger. Interestingly, Equitable PCI and BDO had earnings per share (EPS) of 4.89 and 2.89 respectively in 2006 which decreased to a 2.57 post-merger. This can be due to an acquisition being an immediate cost to shareholders bringing in value creation and revenues only in subsequent years resulting in a lower EPS for the combined entity immediately. As of 2015, BDO Uni banks EPS remain at a healthy 6.84. Following the merger in August 2007 BDO Uni bank was given an improved debt rating especially with better conditions in the Philippine banking sector. At the time of the re-rating BDO Uni bank shares traded with a 2.8 price to book ratio and a prospective P/E ratio of 18.

In addition, Equitable PCI and BDO had a book value per share of 63.7 and 22.91 in 2006 which settled at 23.45 post-merger. Eight years post-merger, book value per share settled at 53.17 in 2015 due to increases in growth, productivity and financial stability. *Figure 4* shows Equitable PCI banks' revenue figures from 2003 to 2006. A small decline in revenue is observed in 2005 due to some depositors and borrowers fleeing the bank due to uncertainties arising from a possible merger with BDO.

TABLE 8

Bank Name	Year	Net Goodwill	Total Interest income	Provisions Credit Losses	Total Revenue	Total Share Capital
BDO	2004	0	6767	187	3420	9145
BDO	2005	600	8901	292	4583	9481
BDO	2006	662	11502	245	6086	9620
BDO Uni bank	2007	.	12826	1429	9696	16163
BDO Uni bank	2008	.	14256	774	9506	23020
BDO Uni bank	2009	.	18344	1288	12373	28020
BDO Uni bank	2010	.	18495	1629	12994	29736
BDO Uni bank	2011	.	24849	1642	13755	31074
BDO Uni bank	2012	.	30020	1475	16956	34679
BDO Uni bank	2013	1482	34569	1600	18228	40958
BDO Uni bank	2014	.	30773	1293	17008	40958
Equitable PCI	2004	15240	9781	1035	5954	7270
Equitable PCI	2005	15680	11891	715	6985	7270
Equitable PCI	2006	.	9742	407	7285	7270

TABLE 9

Bank Name	Year	Customer Acceptance	Long Term Debt	Total Deposits By Banks	Total Deposits by Customers
BDO	2004	0	27334	0	112445
BDO	2005	10047	19939	5412	147146
BDO Uni bank	2006	0	45291	0	199858
BDO Uni bank	2007	.	44325	.	339769
BDO Uni bank	2008	.	74656	.	481318
BDO Uni bank	2009	.	67366	.	631749
BDO Uni bank	2010	.	60062	.	686561
BDO Uni bank	2011	.	88745	.	774384
BDO Uni bank	2012	.	105849	.	858556
BDO Uni bank	2013	37259	73926	8067	1118930
BDO Uni bank	2014	.	84167	.	1375057
Equitable PCI	2004	25849	17224	108	187259
Equitable PCI	2005	18521	32448	76	206130
Equitable PCI	2006	.	31543	122	223119

FIGURE 4
REVENUES OF EQUITABLE PCI BANK FROM 2003 TO 2006

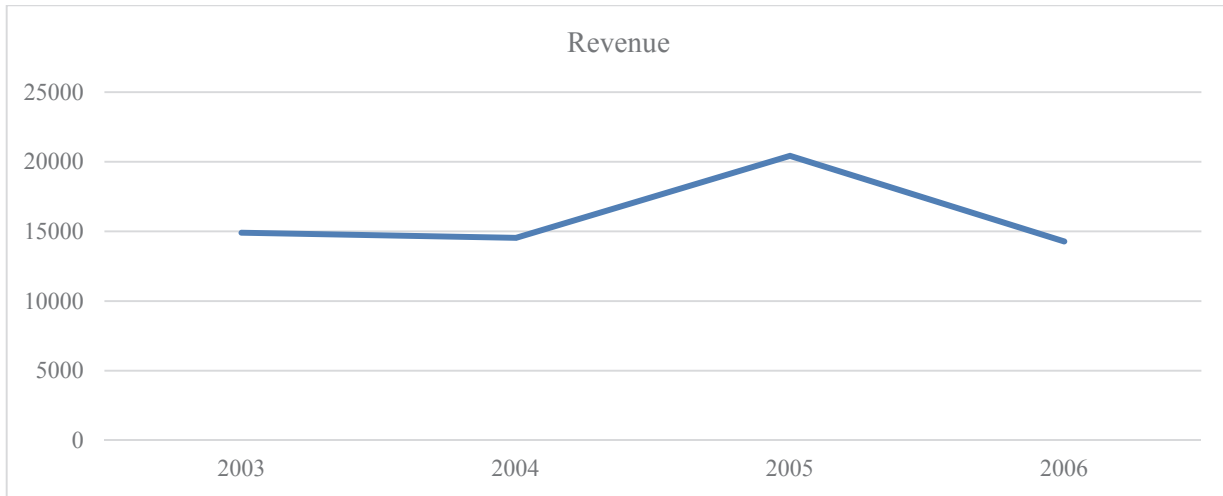
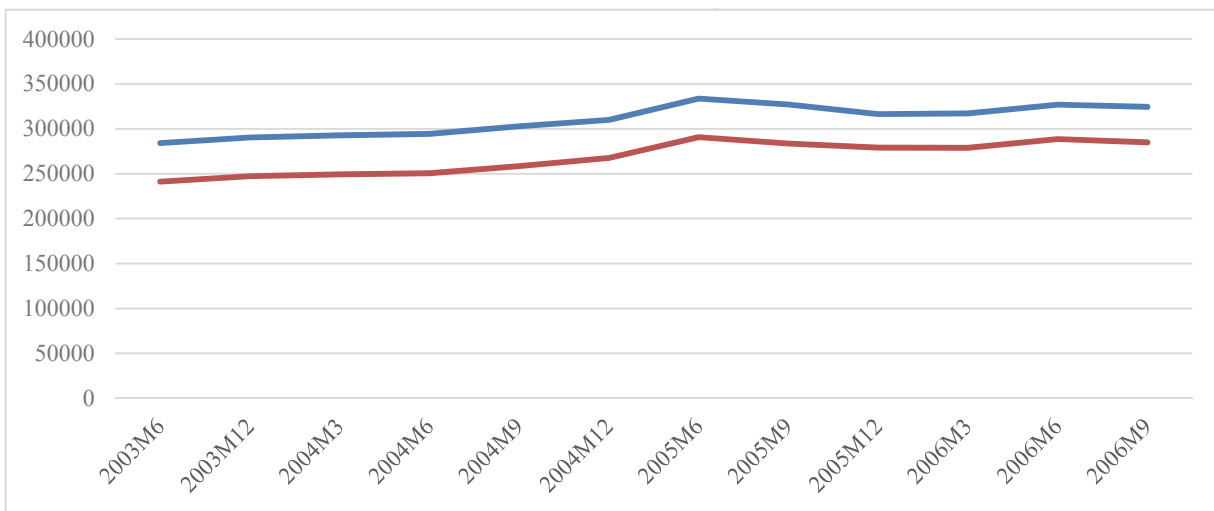


FIGURE 5
EQUITABLE PCI BANKS' ASSETS AND LIABILITIES FROM 2003 TO 2006



The blue for total assets and red for total liabilities

FIGURE 6
REVENUES OF BDO BANK TILL 2006 AND BDO UNI BANK 2006 ONWARDS

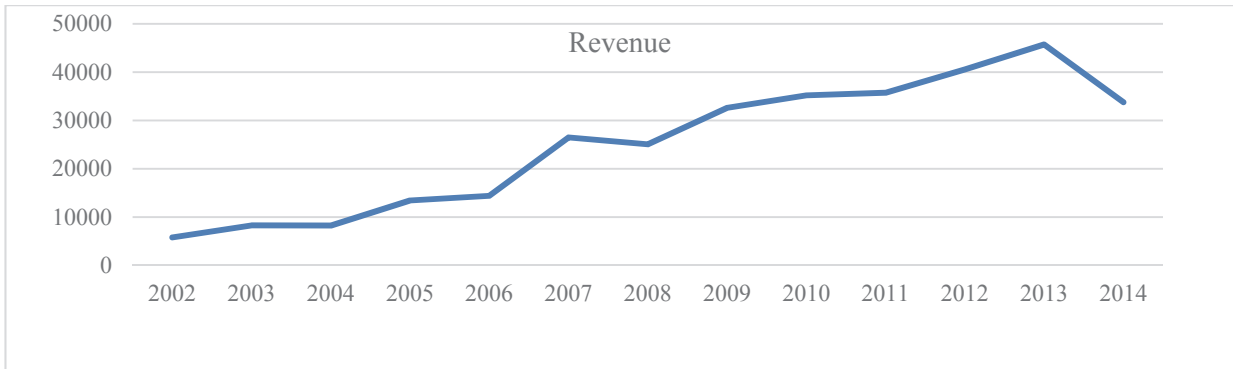
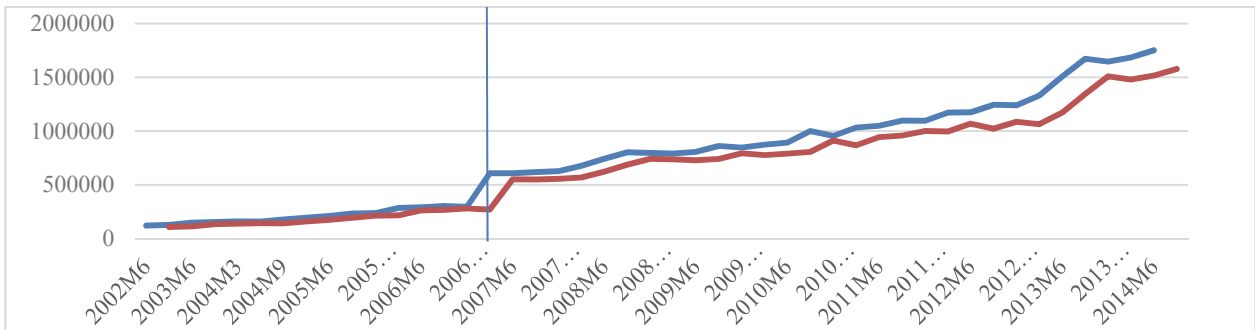


FIGURE 7
BALANCE SHEET DATA FOR BDO BANK TILL 2006 AND BDO UNI THEREON



Note: Blue for total assets and red for total liabilities

Source: BDO, Equitable PCI and BDO Uni bank financial statements.

Figure 5 shows that Equitable PCI had a stable reserve of assets and liabilities during the 2003-2006 sample period. *Figure 6* depicts revenues of BDO till 2006 and BDO Uni bank for the 2006-2014 sample period. *Figure 6* shows a significant upward trend and increases in revenue leading up to 2013. In addition, *Figure 7* shows total assets and liabilities of BDO up till 2006 and BDO Uni bank thereon for the 2006-2014 window. *Figure 7* shows a prominent increase in assets and liabilities with the continuation of the upward trend observed before post-merger as well. Moreover, the merger resulted in BDO Uni bank's minimum capital required increasing to 700 million USD and subsequently settled with a market capitalization of 2 billion USD. *Table 10* shows the present status of BDO Uni bank as the number one bank in Philippines, a decade from the merger. *Table 11* shows the gradual increases in dividends per share (DPS) and diluted earnings per share (EPS).

TABLE 10
PHILIPPINE BANK ASSET DETAILS IN MILLIONS OF PHP AS OF MARCH 2017

Ranking	Commercial Banks	Assets in millions of PHP
1	BDO Uni bank	2,262,034.65
2	Metrobank	1,589,447.27
3	BPI	1,451,377.01
4	Land Bank	1,375,686.17
5	PNB	740,419.12
6	Security Bank	729,174.82
7	China Bank	539,268.82
8	DBP	512,662.51
9	Union Bank	449,289.26
10	RCBC	425,287.94

Source: Philippine Central Bank as of 2017.

TABLE 11
KEY ACCOUNTING VARIABLES FOR BDO UNI BANK FROM 2012-2016

	2012	2013	2014	2015	2016
Revenue	1,842.53M	2,058.03M	2,082.02M	2,267.12M	2,593.86M
Operating income	370.50M	568.50M	605.49M	698.90M	707.53M
Income before tax	370.50M	568.50M	595.10M	657.08M	682.66M
Net income	343.03M	532.33M	513.75M	549.40M	549.40M
Diluted EPS	0.1	0.13	0.13	0.14	0.14
Dividends per share	0	0.04	0.02	0.02	0.02
Total assets	30,256.09M	37,715.99M	41,698.54M	43,202.72M	46,796.85M
Total liabilities	26,496.68M	34,012.86M	37,682.02M	38,960.59M	42,420.99M
Total equity	3,743.41M	3,688.63M	4,002.36M	4,228.88M	4,360.91M
Operating cash flow	683.45M	869.91M	774.68M	180.22M	891.45M

TABLE 12
SELECTED MERGERS, ACQUISITIONS AND CONSOLIDATION OF PHILIPPINE BANKS
FROM 2004 TO Q1 2014

Date	Activity
2005	BDO Bank acquired 66 of the 67 Philippine branches of Singapore's United Overseas Bank for 600 PHP million.
2005	BDO Bank purchased the Go family's 24.76% stake in Equitable PCI Bank for 10.2 Pbn.
2007	BDO Uni bank merged with Equitable PCI Bank, resulting in combined assets of 613 Pbn and combined deposits of 435 Pbn.
2009	BDO Uni bank. Inc. acquired GE Money Bank for 1.3 Pbn.
2012	BDO Unibank, Inc. acquired Rural Bank of San Juan, Inc., adding 30 branches to the former
2013	BDO Uni bank, Inc. signed an agreement to acquire 99.99% of Citibank Savings, Inc., Citi's thrift banking arm in the Philippines
2014	BDO Uni bank, Inc. expressed interest in acquiring the trust business of Deutsche Bank AG, Manila Branch, which adds 70 Pbn.

CONCLUSION

BDO Uni bank moved to the number one position in the Philippine Banking Industry following the merger of Equitable PCI bank (third largest bank) with BDO (the fifth largest bank). The acquisition was hailed as a bold precarious move driven by Hubris from the BDO management. This study provides a survey of literature on motives behind M&A's and key factors that affect M&A outcomes. In addition, this study identifies the following factors as key to the success of this particular merger and lessons that can be generalized to other bank mergers. 1. Successfully integrated two distinct banking cultures. 2. Both management teams agreed upon the merger. 2. Both management teams had prior experience in mergers. 3. Revenue synergies were readily identified and utilized. 4. Cost efficiencies were identified and efficiently utilized. 5. Improved balance sheet management. 6. Affiliation of a large block-holder (SM group) provided better monitoring and a positive signal to the markets. Hence, due to efficient integration strategies and governance practices pursued by BDO management pre and post-merger the deal was a success. This particular merger provides evidence supporting value creation in M&A's. Both banks were experienced in M&A activity and the management agreed on the acquisition.

Despite initial skepticism, frictions and adverse reactions by various market participants, it has proven to greatly transform the Philippine's banking landscape. Finally, going forward a decade into the future, this particular merger still remains the most ambitious and controversial yet clearly a successful merger in the Philippine banking history.

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