Will financial distress lead to banks Merger and Acquisition in Bangladesh?

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Abstract

The paper discusses banks merger and acquisitions (M&A), an important and latest issue for developing economies like Bangladesh. The study is theoretical and analytical in nature. The extensive review of existing literature shows that bank M&A has been growing rapidly on the backdrop of financial deregulation and market competition across the world. However, the positive results of M&A on banking performance are still not well documented. Against the backdrop of current macroeconomic condition and political instability, we tend to argue that increasing non-performing loans, higher interest rate spread, and poor corporate governance could lead to bank massive failures and ultimately increase M&A in banking industry of Bangladesh. A number of policy measures have been recommended.

Key words: bank merger and acquisitions, bank failure, non-performing loan, interest rate spread

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1. Introduction

Mergers and Acquisitions (hereafter M&A) has been in the mainstream news in the recent past (Massoudi and Fontanella-Khan, 2016, Economist, 2016; 2017). Global trend shows a record breaking $5 trillion worth of deals worldwide in 2015 which was more than a one-third increase over 2014 and it was $4.4 trillion in 2007(Liner, 2016). Globalization and financial deregulation of banking sector went through a period of considerable consolidation during 1990s. The financial world has experienced the down side of financial innovation and deregulation in the recent global financial crisis which lead to massive bank failures in the developed economies.

Financial sector of Bangladesh has been experiencing a period of stagnation due to macroeconomic and political instability (Uddin et al., 2017). The non-performing loans (NPL) in the banking sector has increased by Tk11,237 crore in the first three months of the current year. At the end of March, the total NPL stood at Tk73,409 crore which is 10.53% of total outstanding loans. Excess liquidity in the banks stood at Tk1,22,073 crore at the end of 2016 while it was Tk1,20,679 crore in 2015[3]. Declining non-interest income[4] indicates banking sectors heavy reliance on interest income. Consequently, interest rate spread (IRS) has started increasing since 2013. On top of that, the recent Banking Companies (Amendment) Act-2017 could add insult to injury[5].

In this situation, we argue that changes in bank corporate governance structure could lead to the family-dominated board of directors who would definitely work for their own interest. This may increase huge ownership concentration risk as well preferential credit disbursements for directors' favorite and own business group. On top of that, this new practice could trigger an even significant increase in NPL which would ultimately lead to capital erosion[6] and banking failure. Moreover, decreasing interest rate, excessive

[3] Bangladesh Bank Financial Stability Assessment Report April-June, 2017

[4] Non-interest income is bank and creditor income derived primarily from fees including deposit and transaction fees, insufficient funds (NSF) fees, annual fees, monthly account service charges, inactivity fees, check and deposit slip fees, and so on.

[5] The proposed amendment allows the doubling of the number of directors (currently 2 members are allowed to seat on the board from the same family) in a bank's board from a single family and extends the tenure of directors (As per the proposed legislation, the tenure of bank directors would be extended to nine years from the current six years).

[6] Nine banks, including four state owned commercial banks, have faced serious capital shortage due to high NPLs. Retrieved on 5th December, 2017 from https://thefinancialexpress.com.bd/economy/bangladesh/nine-banks-capital-shortfall-swells-to-tk-177b-in-q3-1512326793

liquidity, unfair competition and market saturation could trigger massive banks' failure which would affect not only financial sector but also real sector of the economy.

On this backdrop, it is argued that financial distress could lead to increase in bank M&A activities in the nearest future. However, existing literature is clearly divided on the short and long-term benefits of M&A. M&A lead to better performance (Okpanachi,, 2011, Abbas et al**.,** 2014; Daniya et al., 2016) while some researchers reported negative effect of M&A on bank performance (Antoniadis et al., 2014; Kandil, et al., 2014; Gattoufi et al., 2014, Rao-Nicholson et al., 2016;). Therefore, financial regulators must take proactive measures in order to prevent the financial distress in the first place by imposing strict regulatory control and improving corporate governance. Furthermore, it would be detrimental to overall economy, if the central bank issues new license to open more banks under political consideration.

Although the study focuses primarily on literature review of M & A but we have used secondary data extensively in support of our argument. The rest of the paper is organized as follows. In section two, we briefly discuss the existing literature. The current macroeconomic condition and banking sector performance are analyzed in the section three followed by an analysis of bank failure and M&A. Finally, conclusions and policy recommendations are discussed in the final section.

2. Literature Review

Banks M&A literatures have been growing in the recent past. A number of theories have been applied in the previous studies to explain M&A. Such as, efficiency theory of merger [Weitzel, U., &

McCarthy, K. J. (2011), Daniya, A. A., Onotu, S., & Abdulrahaman, Y. (2016)], neoclassical theory [Mitchell, M. and Mulherin, H. (1996) and Petmezas, D. (2009), (Polemis, M. L., & Paleologos, J. M. (2014)], behavioural theory [Shleifer, A. and Vishny, R. (2003), Polemis, M. L., & Paleologos, J. M. (2014)], resource dependency theory [Kiel, G., & Nicholson, G. (2003), Morris, T. (2004), Das, P., & Rao, S. P. (2011), and Kandil, T., & Chowdhury, D. (2014)], and Jensen, M.C., (1986)] have applied theory of managerial discretion. All these theories are directly and directly are related to the merger and acquisition deal.

According to the efficiency theory of merger, it suggests that mergers will only occur when they are expected to generate enough realizable synergies to make the deal beneficial to the parties, bidder and target. It is the symmetric expectations of gains which results in a 'friendly' merger being proposed and accepted. If the gain in value to the target was not positive, it is suggested that the target firm's owners would not sell or submit to the acquisition. However, and if the gains were negative to the bidders' owners, the bidder would not complete the deal. Hence, if we observe a merger deal, efficiency theory predicts value creation with positive returns to both the acquirer and the target. Daniya, A. A., Onotu, S., & Abdulrahaman, Y. (2016).

Mitchell, M. and Mulherin, H. (1996) and Petmezas, D. (2009), Polemis, M. L., & Paleologos, J. M. (2014), highlight the theory of merger waves. They emphasise the neoclassical theory that assumes capital markets are efficient when there are merger waves which result from certain shocks of an industry's economic, technological or regulatory environment.

Shleifer, A. and Vishny, R. (2003), Polemis, M. L., & Paleologos, J. M. (2014) state that the behavioural theory consists of managerial and overvalued shares theory. According to the managerial discretion theory, there is an inverse relationship between the merger activity and the fraction of shares held by the largest shareholders. On the contrary, the overvalued shares theory argue that the merger activity depends on the degree of optimism in the stock market.

Moreover, a number of researchers such as, [Morris, T. (2004), Nicholson & Kiel (2007), Das, P., & Rao, S. P. (2011), and Kandil, T., & Chowdhury, D. (2014)] apply resource dependence theory that emphasize the motives of mergers in the banking sector. As the theory states, there are some economic conditions in a banking environment which affect

M&A deal. Such as, healthy financial situation, competitiveness among the players and the interest rate.

In addition, Jensen, M.C., (1986) has applied theory of managerial discretion who claims that it is not over-confidence of the managers that drives unproductive acquisitions, but rather the presence of excess liquidity[7] or free cash flow (FCF)[8]. Since they have excess liquidity, manager normally decides to overpay auction and it leads to high probability of failure to have synergy.

Barros, C. P., & Caporale, G. M. (2012) argue size creates further pressure on managers owing to the difficulty of managing large institutions. It is argued that mergers are not always beneficial as they might make firms more aggressive when they compete in quantities. This is supported by Pinter, E. (2011). This is due to the fact that many of the cost of operation do not increase proportionally with the size of the company. Welborn (2004) cited in the Pinter, E (2011) paper when a group diversifies the risks of diversified business lines, it usually reduces the volatility of profits, and thus the capital cost. In addition, if the groups are showing an intensive financial strength, this means they take a lot of advantages are successful, - the efficiency increases - then the product or service mix improving, and have better access to customers, and shareholders' value and return on equity increases.

In addition, Gattoufi, S. et al. (2014) argue that there is a strong belief among the regions decision makers and authorities that facilitating the cross-border economic activities within GCC countries and has a crucial impact on the ongoing economic development efforts. Moreover, the size of the bank is also equally important to have decision to invest abroad. This notion is supported by the Focarelli, D., & Pozzellolo, A. F. (2001), the size of the banks is the key determinant of the decision to expand in abroad. Moreover, previous studies of

A scenario of Islamic banks, total asset size as well as average asset size among the geographical regions have presented in the following table 2.1;

Table 1; Asset size of the Islamic banks by Geographic region as of 2016

[7] Excess liquidity means additional money that keep without use.
[8] Free cash flow (FCF) indicates the concurrent flow of money.

Name of the Region	No. of Banks	Total Asset (US$ mil)	Average Asset Size
ASEAN	34	191,286.00	5,626.06
GCC	55	530,971.00	9,654.02
MENA	109	980,856.00	8,998.68
SOUNTH ASIA	18	39,671.00	2,203.94
AFRICA	30	24,337.00	811.23
OTHERS (UK)	7	16,411.00	2,344.43

Source: Orbis Banks Focus (Bankscope) data base.

A rough estimation (data is not available in the data base according to each country of the region) of the Islamic banks has shown in the table 1. According to the estimations, it represents asset size of the Islamic banks located in the geographic regions. Although Islamic banks has launched four decade before, its size is not increase accordingly if we compare with conventional peer. So, it becomes necessary for the Islamic financial institutions especially Islamic banks to be merged with a view to being mega Islamic bank. It will minimize the probability of "too small to have performance as well as efficiency".

Why much more concern about the size and to expand the baking operation accordingly. A number researchers such as, Iqbal, Z. (2008) and Sanfilippo Azofra, S., Garcia Olalla, M., & Torre Olmo, B. (2008), the main objective is that to add value to stakeholders (shareholder, manager and government). On top of that, Ibrahim, M. H., & Rizvi, S. A. R. (2017) says, currently the size of the Islamic banks is too small to have economics scale. Therefore, it is better to merge to gain the economics of scale. Moreover, Datuk Seri Zukri Samat, mentions in the press conference on 28 & 29 of May 2017, creation of mega Islamic banks through consolidation could be rival not only for the other Islamic banks but also the "Big boys" or "Giants" from the conventional side. Supporting this idea by Dr Alexander von Pock, principal, Financial Institutions Group, AT Kearney Middle East says that Mergers and acquisitions offer a way to build more powerful players with better chances to compete. In addition, deputy governor of Bahrain monetary authority states that if Islamic banks are growing so no need to be smaller Islamic banks. Following paragraph represent the motives for M&A.

Being an acquirer and target depends on the several factors which is mentioned and supported by the study of Beccalli, E., & Frantz, P. (2013) a history of high growth, greater cost efficiency, and lower capitalization becoming an acquirer. In contrast, banks are more likely to be targets if they have lower free cash flows, lower growth rate, high potentiality, less efficient, are relatively illiquid, and are under-capitalized. Lebedev, S. et al., (2015) study developed and emerging economies by studying two factors like, antecedences (country characteristics, institutional factors, network characteristics, entry mode etc) and performance of the firms. They conclude acquisitions typically destroy shareholder value for the acquirer but target firms typically gain value from M&As in developed economies. On the other hand, in emerging economies, there is no established trend for the acquirer's gain – acquisitions, it may create or destroy shareholder value for the acquirer.

Cross border M & A is also getting momentum in the recent past. Amihud, Y et al. (2002) mentions that in case of the cross border merger and acquisition there is a risk of insolvency. If the acquisition of the foreign target fails and the domestic bank's (acquirer's) solvency is threatened, then the acquiring bank may be bailed out either by its own home or domestic regulator or perhaps by the host regulator (the regulator of the target bank). As a result, cross-border mergers may increase the insolvency risk exposure of either one or both the domestic (acquirer) and host (target) bank regulators. This conventional wisdom is based on the traditional notion that it is better for a bank not to put all its "eggs in one basket" and thus geographic diversification is a naturally risk reducing activity.

Zou, H., & Simpson, P. (2008) the literature has barely discussed M&A in the developing economies, something initially justified by the fact that transactions taking place in developing countries tend to be much smaller in scale and number than those in developed countries. M&A activity can be seen as a means of managing resource dependencies through absorption and integration at a low-cost base and acquiring or consolidating market power position.

Not all M&A lead to success. In deed empirical studies give inconclusive evidence. A positive relationship between bank performance and M&A deal has found by Abbas et al. (2014). The study has conducted in the US banking sector and found there is a direct positive performance after M & A in terms of the productivity, profitability as well as shareholders' value. It was buttressed by Daniya, A. A., Onotu, S., et al. (2016) and Okpanachi, J. (2011). They studied banks of Nigeria and revealed improved and robust financial performance owing to merger and acquisition leading to more financial efficiency in the Nigerian banks. In addition, Okpanachi, J. (2011) implies that between pre and post merger and acquisition (M& A), post mergers and acquisitions' period was more financially efficient than the pre-mergers and acquisitions period.

Whereas following number of researchers found negative relationship between M&A deal and performance of the banking industry. Kandil, et al. (2014), Gattoufi et al. (2014) find that M&A activity don't have significant impact on operational performance of banks involved in M&A. Piloff, et al.(1998) and Goyal, K. A., & Joshi, V. (2011) claimed acquisitions often have a negative impact on employee behavior resulting in counterproductive practices, absenteeism, low morale, and job dissatisfaction it appears that an important factor affecting the successful outcome of acquisitions is top management's ability to gain employee trusts. Amihud, et al. (2002), the abnormal returns to acquirers are negative and significant., Banal-Estanol and Ottaviani (2007), found that merger and acquisition have negative impact on the various factors like profitability, efficiency, abnormal return, liquidity, leverage, size, employee behavior on banking industry. Besides, positive and negative findings, mix result has found by the following study, Rao-Nicholson et al. (2016) studied with public listed companies from ASEAN countries and found negative effect of M & A deal on the performance of the banks.

At the same time, Altunbaş, Y., & Marqués, D. (2008) and Antoniadis et al. (2014) find mixed result, on average, bank mergers have resulted in improved performance. In case of the domestic deals, it can be quite costly to integrate institutions which are dissimilar in terms of their loan, earnings, and cost, deposit and size strategies. For cross-border mergers, differences between merging partners in their loan and credit risk strategies are conducive to higher performance, whereas diversity in their capital and cost structure has a negative impact from a performance standpoint. Sufian, F., & Habibullah, M. S. (2014) finds Malaysian banks and empirically found that the acquiring banks have been relatively more productive compared to the target banks. The Malaysian financial sector consolidation can be traced back to the early 1990s when Bank Negara Malaysia (BNM) introduced a two-tier banking system as an incentive to promote mergers among the small domestic banking institutions.

More recently, Shirasu, Y. (2017) has found that acquirer and target banks became failure to have positive affect of M&A due to issuing gross loan and increasing non performing loans. It was stated that, acquirer banks expand, issuing higher grossing loans. After a certain period, acquirer banks accumulate loans, thereby enhancing their equity. However, simultaneously, acquisitions continue to lead banks toward amassing NPLs; these banks also end up incurring more costs and losing their profitability in the long run. Therefore, as part of cross-border deals, strong legal systems and stringent regulations could enable Asian banks to operate effectively by undertaking M&A between countries with different economic systems. YW Tang, R., & M. Metwalli, A. (2013) study Bangladesh, Pakistan and India during 2000 to 2009 and an interesting result was found by them M&A in India is a lot more active than that in Pakistan or Bangladesh. In Bangladesh, non-Bangladeshi firms acquiring Bangladeshi companies accounted for more than 90 percent of all large M&A value. In their study period they mentioned about two cases of bank mergers in Bangladesh[9].

[9] Rupali Bank Ltd and Bandar Bin Mohammad Bin Abdul (Saudi Arabia) (2005-2006) and Oriental Bank Ltd and ICB Financial Group Holding SAE (Switzerland) (2008)

3. Why size is matter in Islamic banking sector.

Due to the difference in methodology between Islamic and conventional banking system, it is almost impossible for the two banks to be merged. However, there is a room for Islamic subsidiary of the conventional banks to merge with Islamic banks. Following are the argument for M&A in the Islamic banking sector.

Roberts, A., Wallace, W., & Moles, P. (2003) mentions that the reasons why one financial institution merged with another institution are due to the rationale and the drivers. Rational indicates strategic implementation whereas, drivers indicates control of the capacity from the economy.

Barros, C. P., & Caporale, G. M. (2012) argue that size also creates further pressure on managers owing to the difficulty of managing large institutions. It is said that mergers are not always beneficial as they might make firms more aggressive when they compete in quantities. This is supported by Pinter, E. (2011) who mentions that this is due to the fact that many of the cost of operation do not increase proportionally with the size of the company. With respect to Islamic bank particularly, Ibrahim, M. H., & Rizvi, S. A. R. (2017) state that size of the Islamic bank is lower as compared to conventional banks. So, it becomes concern of too small to have the economics of scale and scope. Moreover, deputy governor of Bahrain monetary authority states that if Islamic banks are growing so no need to be smaller Islamic banks. Islamic banks are expected to achieve both economies of scale and scope if M & A activities would be implemented.

Datuk Seri Zukri Samat, Ex. Chief Executive Officer (CEO) of BIMB Holdings Bhd. said in the press conference on 28 & 29 of May 2017, creation of mega Islamic banks through consolidation could be rival not only for the other Islamic banks but also the “Big boys” or “Giants” from the conventional side. It would help to survive in the competitive market, boost industry growth, huge potentiality to cross the border, and able to be a global hub for Islamic banking sector. Supporting this idea by Dr Alexander von Pock, principal, Financial Institutions Group, AT Kearney Middle East says that Mergers and acquisitions offer a way to build more powerful players with better chances to compete. Finance Minister of Bangladesh, Abul Maal Abdul

Muhith[10] states that those banks like BASIC bank and National bank Bangladesh Limited face financial problems due to the huge amount of non performance loans (NPLS), there is provision to merge with healthy financial institutions under the act.

According to Iqbal, Z. (2008) incentives are necessarily to increase size through consolidation in order to lower the cost of funding and increase the value of shares. It is important to distinguish how M&A activities work in case of the Islamic financial industry or institutions. As mentioned by the Iqbal, Z. (2008) there is two things should be considered regarding consolidation of the Islamic financial institutions. Firstly, benefits arising out of economies of scope and scale, Secondly, benefits from enhanced risk management or risk sharing strategy through diversification, these two areas make a strong case for thinking seriously about consolidation in case of the Islamic financial institution. A well diversified bank has better expected return-risk trade-offs resulting in lower variability of profits and higher security for depositors.

Kandil, T., & Chowdhury, D. (2014) argue that many acquisitions are not failures from an ex post perspective and suggest that an acquirer may sell a business it has improved or a business that it once had synergies with but no longer does. There are two main reasons for M&A like efficiency gains that arise through economies of scale or scope, which is due to the increased synergy between the involved Islamic banks and the strategic rationale that follows the idea that mergers and acquisitions can change the structure of the market which in turn affects the Islamic banks' profits.

Sufian & Habibullah, (2009) the central bank of Malaysia has always encouraged the domestic banking institutions to merge. Efficient bank is assumed to be well organized and has a more capable management. The idea is that since there is room for improvement concerning the performance of the less efficient bank, a takeover by a more efficient bank will lead to a transfer of the better management quality to the inefficient bank. This will in turn lead to a more efficient and better performing merged unit.

[10] http://www.dhakatribune.com/business/banks/2017/12/12/muhith-new-banks-no-problem/ access on dated 22.12.2017

Table 2.1; Summary of M&A on the Islamic banking sector.

Sl.	Authors & Year	Country, Sector Duration	Variables	Methodology	Findings
1	Iqbal, Z. (2008)	General, Islamic Financial Institutions (Islamic banking sector)	General discussion.	General Discussion on IFIs.	It is essential that IFIs expand the scope of their products and services to meet the challenges of domestic and international markets. Due to small size of the economy, larger banks unable to use resources and minimize the cost efficiently and effectively.
2	Kandil, T., & Chowdhury, D. (2014)	UK, Banks, 1999 to 2009	ROA, ROI, Bank size (bank's revenue), Financial leverage.	Regression model	ROE, ROI increases. Target shareholder enjoy short term positive rerun. The announcement of MA has immediate effect on the share price.
3	Ibrahim, M. H., & Rizvi, S. A. R. (2017)	Bangladesh, Egypt, Indonesia, Jordan, Malaysia, Pakistan, Tunisia, Turkey along with GCC countries, Banks, 1993 to 2004.	Z-score (measure of stability) , bank size (total bank asset), regulations, Control variable lending activity, bank profitability, bank liquidity, economic growth, and inflation.	GMM, cross country (dynamic panel)	Larger Islamic banks are more stable, at least when they surpass a certain threshold size. Benefits of having bigger Islamic banks or mega Islamic banks. Improving the regulations.

4. Current state of banking industry in Bangladesh

Bangladesh is one of the fastest growing south Asian countries with a CAGR of 5.6% in the last ten years and has a vision to reach upper-middle-income country status by 2021. This growth was accompanied by a significant decline in poverty, an increase in employment, greater access to health and education, and improved basic infrastructure. As a result, the once poor country is now considered middle income[11]. The existing finance-growth literature shows the relative importance of finance on economic growth. Banking sector dominates the financial sector development as capital market has not yet developed (Beck and Levine, 2004; Levine, 2005). Bangladesh has experienced tremendous growth in banking industries after financial liberalization policy in 1990s[12]. Domestic credits to private sector by banks have increased from 2.61% of GDP in 1974 to 44.26% in 2016. After economic reform and financial liberalization in the nineties1the economy has started to grow even faster[13].

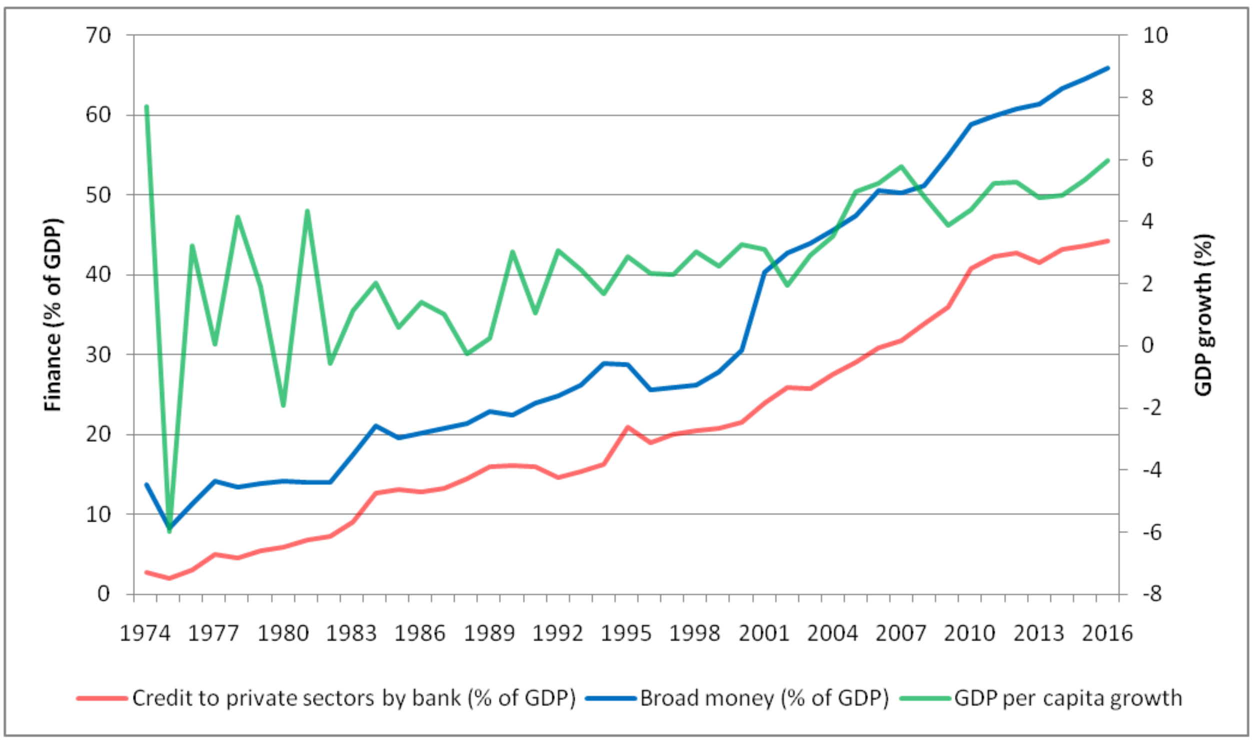

Figure 1: Finance and economic growth of Bangladesh

[11] Asian Development Bank, Bangladesh: Challenges and Opportunities in Moving to Upper Middle Income Status. Retrieved on 26th November, 2017 from https://www.adb.org/news/features/bangladesh-challenges-and-opportunities-moving-upper-middle-income-status

[12] Financial Sector Reform Program (FSRP)

[13] Bangladesh enjoys a CAGR of 4.8% and 5.6% from 2000 to 2016 and from 2007 to 2016 respectively

Table 1 below shows the recent trend of banking sector development in Bangladesh. Number of depositors with commercial banks has been doubled from 2005 to 2015, however, number of borrowers actually declined. The number of commercial bank branches per 100,000 adults has increased but account at a financial institution decreased in the same time period. It is observed that commercial banks are predominantly urban based and most of their branches are located in big cities with strong depositor base. Only nationalized commercial banks and very few private commercial banks have extended network of branches in the rural areas. Consequently, most of the rural people do not have easy access to finance.

Table 2: Banking sector development in Bangladesh

	2005	2008	2011	2012	2013	2014	2015
Depositors with commercial banks*	255.6	270.2	465.4	533.9	513.4	522.8	565.3
Borrowers from commercial banks*	87.8	85.1	87.0	85.4	79.2	74.4	74.5
Commercial bank branches+	6.9	7.0	7.7	7.9	8.0	8.2	8.4
Account at a financial institution-	NA	NA	31.74	NA	NA	29.14	NA

Notes: * per 1,000 adults; + per 100,000 adults; - % age 15+
Source: World Bank IBRD-IDA

Table 3: Banking sector stability

	2012	2013	2014	2015	2016
Bank capital to assets ratio (%)	5.42	6.04	5.85	5.43	---
Bank nonperforming loans to total gross loans (%)	9.73	8.64	9.37	8.40	9.20
Bank liquid reserves to bank assets ratio (%)	11.69	12.49	11.17	14.47	15.40
Net Interest Margin	4.54	3.73	2.29	2.34	---

Source: World Bank IBRD-IDA, GFD and Bangladesh Bank Financial Stability Assessment Report

Table 3 shows the trend of banking sector stability indicators for the last five years. Non-performing loans have been increasing alarmingly in the recent past. Despite the pressure of excess liquidity and non-performing loans (NPLs), most public and private banks have seen an increase in their operating profits in the first six months of the calendar year compared to the same period a year ago. The non-performing loans in the banking sector increased by Tk11,237 crore in the first three months of the current year. At the end of March, the total NPL stood at Tk73,409 crore which is 10.53% of total outstanding loans. The default loan of private banks stood at Tk29,727 crore in the first quarter of the year, up 28.93% from the last three months of

2016. The state banks' default loans expanded from Tk4,691 crore to Tk35,716 crore during the first quarter of the year. The latest central bank data showed that the excess liquidity in the banks stood at Tk1,22,073 crore at the end of 2016 while it was Tk1,20,679 crore in 2015[14]. Increasing NPL shows the continuous downward pressure on banks' capital relative to assets.

Table 4: Dynamics of inflation and interest rate.

	Five year average					Latest five year				
	91-95	**96-00**	**01-05**	**06-10**	**11-15**	**2012**	**2013**	**2014**	**2015**	**2016**
Lending interest rate (%)	14.88	13.36	11.70	12.55	12.96	13.94	13.59	12.95	11.71	10.41
Deposit interest rate (%)	8.63	8.56	7.10	7.11	9.34	10.22	11.72	9.80	8.24	6.20
Inflation, consumer prices (annual %)	5.72	4.88	5.13	7.66	7.63	6.22	7.53	6.99	6.19	5.51

Source: World Bank IBRD-IDA

To accommodate the central bank's expansionary monetary policy, commercial banks reduced their deposit interest rates more than the lending interest rates (Table 4). Recent increasing trend of Interest rate spread indicates increases in non-performing loans in not only SCBs but also PCBs (Figure 2). At the same time, declining trend in non-interest income could also be another contributing factor in higher interest rate spread. The theory of *non-existence of competition*[15] may be weaker in the current banking industry with 57 scheduled banks[16]. However, excessive profit drive at the expense of depositors may be more relevant in the current scenario where depositors' interest is mostly overlooked. The situation is likely to aggravate if the proposed Banking Companies (Amendment) Act-2017 is implemented. As table 4 clearly shows bank wanted to increase income and mostly at the expense of depositors. Decrease in deposit interest rate is significantly higher than the lending interest rate (Table 4). It clearly shows that bank tend not to decrease lending rate as much as deposit rate. However, from 2009 to 2012 interest rate spread decreased from above 5% to below 3%. This could be due to intense competition in banking sectors.

[14] Bangladesh Bank Financial Stability Assessment Report April-June, 2017

[15] Bangladesh Bank Policy Paper: 0804. Retrieved on 26th November, 2017 from https://www.bb.org.bd/pub/research/policypaper/pp0804.pdf

[16] Bangladesh Bank, Banks. Retrieved on 26th November, 2017 from https://www.bb.org.bd/fnansys/bankfi.php

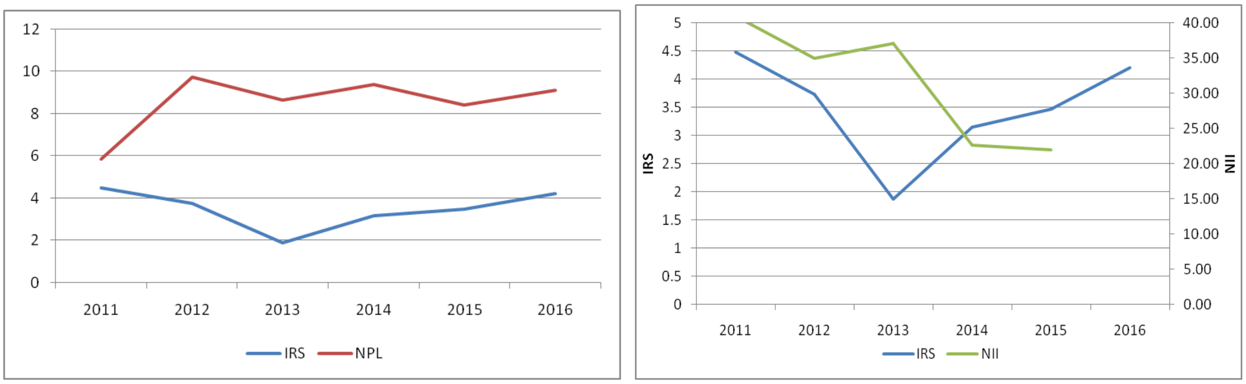

Figure 2: Dynamics of Interest Rate Spread (IRS, %) and Non-Performing Loan (NPL, % of Gross Loan, and Banks' Non-Interest Income (NII, % of Total Income)
Source: World Bank IBRD-IDA, World Bank GFD

5. Bank failure and M&A

Against this backdrop, we tend to argue that the recent proposed changes in bank corporate governance structure could lead to the family-dominated board of directors who would definitely work for their own interest. This is likely to increase huge ownership concentration risk as well preferential credit disbursements for directors' favorite and own business group. The non-performing loan has already exceeded the threshold for the last couple of years. On top of that, this new practice could trigger an even significant increase in NPL which would ultimately lead to capital erosion and massive bank failure. In the current macroeconomic situation, this is not a very unlikely scenario. Banks are currently sufferings excess liquidity risk due to lack of investment opportunities and political stability.

This is only the asset side risk. There is liability side risk as well. Due to lower inflationary expectation, the Central Bank has adopted the expansionary monetary policy to boost investment activities to stimulate output. Consequently, public and private commercial banks have already reduced their deposit interest rates which lead to deposit outflow from commercial banks to government's savings certificate where the interest rate is still significantly higher. Political pressure and upcoming election are the main two reasons of this policy inconsistency. In the short run, banks may not face any problems due to already excess liquidity situation but gradual decline in term deposits due to lower interest rate and lack of public confidence accompanied by the increase in NPL would significantly reduce bank lending capabilities and bank stability. One of the potential consequences in this dire scenario is increasing bank M & A[17].

[17] In a very recent public gather Finance Minister turning down the notion of a messy situation in banking sector riddled with irregularities and lacking good governance,. He said the banks failing to operate properly

6. Conclusion

In conclusion, the paper has discussed bank merger and acquisitions (M&A), an important and latest issue for developing economies like Bangladesh. The extensive review of existing literature shows that bank M&A has been growing rapidly on the backdrop of financial deregulation and market competition across the world. However, the positive results of M&A on banking performance are still not well documented. The current macroeconomic condition like, political instability, increasing non-performing loans, increasing interest rate spread, and poor corporate governance could lead to bank failures and ultimately increase M&A in banking industry of Bangladesh. Therefore, it is recommended that financial regulators must take proactive measures in order to prevent the financial distress in the first place by imposing strict regulatory control and improving corporate governance. Furthermore, in the current economic situation, if the central bank issues new license to open more banks under political consideration, it will be detrimental to overall economy.

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