An ESRC Research Centre
CCP CENTRE FOR COMPETITION POLICY

July 2007

Efficiency and Price Effects of Horizontal Bank Mergers

CCP Executive Summary

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INTRODUCTION

- Comprehending the degree to which efficiency improvements from mergers are passed on to customers is a central concern when determining whether a merger may be legally undertaken.
- The UK retail banking market is relatively concentrated, with a limited number of large banks and a large fringe of smaller banks, and has appreciated a considerable amount of merger activity during the last decade.
- This study provides an empirical assessment of the degree to which interest rates – the effective prices of many financial services – are influenced by horizontal retail bank mergers by examining how both retail interest rates and efficiency changed after 61 bank mergers between 1988 and 2004.

METHODOLOGY

- UK retail banks and building societies are examined: UK building societies are mutually-owned financial institutions, similar to US savings and loans institutions; and retail banks are shareholder-owned large banks.
- In generating the sample, a number of screens are employed, meaning that included in the sample are only:
  - Banks in the UK domestic retail banking market
  - Horizontal mergers
  - Those mergers for which a panel of accounting and price data could be obtained.
- This selection in total leaves 105 banks and building societies which are involved in 61 mergers.
- The data for this study comes from three sources:
  - Annual reports and accounts of individual banks over the period 1988 to 2004
  - Additional data on staff numbers, provided by the British Bankers Association Annual Abstract of Statistics
  - Substantial data sets of interest rates for deposits, unsecured lending and mortgages, provided by Moneyfacts Plc.
- Deposit interest rate data are provided for instant access accounts and notice accounts. These two products are issued by 104 banks, for three different deposit values (small (£500), medium (£5,000) and large (£50,000)).
- The mortgage data are the reference interest rates from which the interest charged on different mortgage contracts for existing customers is assessed, and are provided for 99 banks.
- The unsecured personal lending data are provided at three levels of lending (small (£1,000), medium (£5,000) and large (£10,000), and are recorded for 52 banks in total.
- All data are provided at monthly intervals over an 18 year period from 1988 to 2004, providing 162,972 observations for deposits, 14,455 for mortgages and 4,249 for unsecured lending.
- The cost efficiency of both merging and non-merging banks is calculated and then a regression model is estimated to ascertain the link between interest rates and merger events.

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KEY FINDINGS

Cost Efficiency and Bank Characteristics

- Most UK bank mergers occurred in the first half of the sample period.
- The average level of interest paid or payable on the three representative banking services displays a strong decline across the sample period, making meaningful comparisons of interest rates at different time periods problematic.
- Overall the merging banks are viewed to have higher levels of cost efficiency over the entire sample period.
- Acquiring banks have a statistically significant higher average level of efficiency than target banks, which improves in the years after the merger event.

Regression Model Findings

- The effect of merger on notice accounts, in contrast to the other banking products studied, does appear to be statistically significant.
- For larger quantities (£5,000 and £50,000) invested in notice deposit accounts, a consistent negative change in the interest rates received by customers is reported. This reduction in the level of interest received occurs both immediately after the merger and up to six years after the merger.
- This change can be interpreted as a major decline in the level of interest received relative to non-merging banks. This provides strong evidence that merging banks compete far less aggressively in the market for notice accounts.
- Conversely, before mergers, target banks appear to be pricing their notice deposit accounts for smaller quantities (£500 and £5,000) relatively aggressively, and providing significantly higher rates in the two years before the merger occurs.

CONCLUSION

- Initially, UK bank mergers are seen to be cost efficiency enhancing.
- The time over which efficiency gains are realised is substantial.
- The effect of bank mergers on retail interest rates is mostly statistically insignificant. This finding is in many regards at odds with findings reported for the US or Italian banking markets, where mergers are seen to have a stronger and negative influence on interest rates. This difference may exist for many reasons, including differences in the market structure of the banking markets considered. It is also possible that the influence of bank mergers over market power may be far more limited in larger national markets.
- It is proposed that the price and efficiency aspects which emerge from mergers may not be clearly understood through assessment of market share change alone. And that future work assessing the impact of mergers may choose to investigate possible differential pricing and efficiency effects which develop from the merger process.

THE CCP

The ESRC Centre for Competition Policy (CCP), at the University of East Anglia, undertakes competition policy research, incorporating economic, legal, management and political science perspectives, that has real-world policy relevance without compromising academic rigour.

FOR MORE INFORMATION

The full working paper (CCP Working Paper 07-9) and more information about CCP and its research is available from our website: www.ccp.uea.ac.uk

ABOUT THE AUTHORS

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