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PwC Sees Continuing Growth in Thai and Asia-Pacific Banking M&A Despite Slowdown

Bangkok--PwC Thailand

Asia Pacific is expected to lead the world as most active region for banking merger and acquisition (M&A) in 2013 and beyond, underpinned by rapid economic expansion, mounting middle-class demand for banking products and a growing high-net-worth segment, a PwC report says.

Thai banks and their counterparts throughout Asia Pacific will remain largely insulated from the negative credit pressures affecting their peers in many Western economies, thanks to their strong capital base and macro-economic recovery at home.

Sira Intarakumthornchai, CEO of PwC Thailand, said that domestic deals will continue to drive M&A activities, as banks in the burgeoning region respond to rising competition and the need for greater operational and capital efficiency. This comes despite recent years' decline in M&A in a global banking industry hit by prolonged debt woes—a shift no longer seen as a 'cyclical downturn' but rather representing 'a more permanently changed' economic and regulatory environment.

Global banking M&A transactions continue to decline faster than all-sector M&A, and will record another weak year in 2012, with the total value of completed banking deals globally falling by 37% during the first ten months of last year, compared with a drop of 20% in all-sector global M&A, according to PwC's paper, The Journal – Brave new world: New frontiers in banking M&A.

"The sovereign debt crisis in Europe will continue to affect banking M&A for as long as it persists," Sira said. "The political and economic uncertainty stemming from the Eurozone is making it harder to predict future impairments, agree on valuations, arrange funding and gain shareholder approval. The crisis is also having a significant impact on deal confidence overall."

In the longer term, patterns of banking M&A globally are going into reverse. Deal making will look beyond just prices and valuations, while state bodies are increasingly being drawn ever more closely into M&A decisions, according to PwC's paper.

Banking M&A, which has changed significantly in recent years, is evolving rapidly along new, more complicated and less predictable patterns, said Sira, also adding that deals are becoming more risky for both the institutions and individuals involved.

He explained that the shift of economic power away from North America and Europe and into emerging economies, led by growth in China and India, will be even more compelling. Over the next 40 years, GDP in the E7 economies, driven by these two powerhouses (along with Brazil, Russia, Indonesia, Mexico and Turkey) is expected to grow at a cumulative average of 4.7%, more than double the 2.1% for the G7 economies—the world's largest industrialised markets.

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Other factors—including banking integration, regulatory reform, and strategic shifts—will also become influential drivers for the future of banking M&A, the report found.

“What we’re seeing is that intra-regional deals are already a feature of Asia-Pacific banking, and this is only likely to grow. Large banks from markets like Japan, Korea, Singapore and Malaysia are boosting their exposure to fast-growing Southeast Asia, particularly Indonesia and Vietnam,” he said, adding that the rapid growth in retail banking is also an increasingly strong motive for regional expansion, as banks seek to acquire new clients and develop platforms for growth.

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“Nevertheless, when we look at countries like Thailand, we remain an attractive banking system because of a relatively low credit penetration, sound and resilient economic growth, and expanding middle class. Most major Thai banks are well capitalised and have sound loss-absorption capacities.

“Going forward, we expect them [Thai banks] to seek growth through M&A and expand regionally regardless of their sitting on the buy or sell side, bucking the overall downward trend in global banking M&A,” he added.

The top Thai lenders, already strong in the domestic market, with a combined market share of 70 to 80% of the industry, are likely to look at going international as their next logical step going forward. That said, strengthening local operations while also thinking regionally would be among key challenges for the Thai banking industry in a changing global economic landscape, Sira said.

Southeast Asian banks need to be aware of how global economic forces could affect the markets in which they operate. At the same time, they are looking forward to greater business opportunities for both the real and the financial sectors with the formation of the Asean Economic Community (AEC) in 2016.

Larger Thai corporations have been pursuing regional expansion aggressively for a few years, and local medium-sized businesses are starting to follow suit as well. Large Thai banks have also followed, to support their domestic clients, and are starting to get a better sense of what they might be able to do in a regional market.

For small and medium-sized local banks meanwhile, the priority is to strengthen domestic business to cope with stronger competition. Organisational restructuring and M&A deals were part of that process last year. Business expansion into neighbouring markets should be the banks’ next step, as part of a longer-term plan to prepare for the AEC.

Sira pointed out that national and international regulations are forcing banks to restructure. The most obvious example is Basel III, which will encourage banks to strengthen their capital and could stimulate consolidation in some markets. The vast majority of Asian banks are ready to adopt Basel III capital standards, which are being implemented in much of the region in 2013, even though some Asian regulators have announced delays.

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Thailand has implemented Basel III, which came into effect on 1 January 2013. Central banks around the world have stepped up efforts to strengthen the supervision of financial institutions, improve risk management, and place a greater emphasis on monitoring systemic risks.

Last year, the Bank of Thailand introduced the Basel III capital regulatory framework with a focus on improving capital quality, increasing capital base to provide a cushion in the event of a crisis, and strengthening risk management procedures, especially in the realm of credit risks.

Higher capital requirements under Basel III could be another key challenge for newcomers. Hence, a solid capital base is the best buffer to protect the local banking industry from global risks as well as strengthen its competitiveness.

“The attractive fundamentals of Asia-Pacific banking mean that banks from more mature regions will continue to use M&A to build scale in this region. Again, in some cases, they’ll take advantage of competitors’ exits.”

Conversely, the picture is less gloomy in the US but some banking institutions still have significant restructuring ahead of them. Those in stronger financial shape are well placed to expand overseas. Asia Pacific and Latin America will be the most attractive regions for outbound M&A, as the growth in these regions’ middle income consumers and the rapidly expanding corporate sector demand more services.

Restructuring will remain the most essential driver of banking M&A in Western Europe over the next few years as banks seek to focus on core businesses and exit peripheral activities. Even so, there may be interest from some Chinese banks in distressed European targets that offer the chance to build a niche presence.