Chapter 3
A Resource–Based Approach to Mergers and Concentration of the Banking System in Mexico post Crisis 1994

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ABSTRACT

The strength of the companies is sustained in the resources that it owns that can be considered like a barrier to the entrance for other companies. The case of the banking sector of these resources was affected by the crisis of 1994, devastated with the anti-crisis measures and the entrance of foreign competitors at the end of the 1990s. Under this environment, this chapter analyzes the acceleration of the concentration at the Mexican banking system based on the resource-based theory. To have competitive advantages in resources and a solid global expansion strategy, foreign banks were able to climb to a position in the Mexican banking system, with the subsequent generation of barriers to entry to maintain its leadership.

1. INTRODUCTION

High levels of market concentration are endogenous to Mexico’s authoritarian political and economic institutions (Haber, 2006; Haber & Musacchio, 2006; Haber, Klein, Maurer, & Middlebrook, 2007). The Mexican banking market has been highly concentrated for the past 120 years where a small number of banks have dominated the banking system with the four-firm ratio hovering in the area of 60 to 70 percent (Haber, 2005, 2006). The analysis of the banking system concentration and interaction with the Bank of Mexico from 1910 to 2008 shows a concentration process which accelerated after the 1994 crisis and the bank expropriation.

Concentration in banking industry in an emerging economy plays a complex role (Mohanty, Schnabel, & Garcia-Luna, 2006). Concentration of industry, and more specifically in the banking sector, is not necessarily good indicator for the level of competitive behavior (Claessens & Laeven, 2004). More than a banking concentration problem in many of the emerging economies, instead the problem is the fragmentation of the banking systems. Contrary to what some experts
have argued (Sokoler, 2006), concerns of excessive banking concentration have already arisen in emerging market banking industries resulting from foreign bank mergers and local banks, sufficient to raise concern on market competition.

Banking concentration in local markets is more a pervasive weaknesses of the structure of financial system than a strategy, characterized by some dysfunctions of the legal, regulatory, institutional and economic environment. In some countries have emerged concerns about commercial banking concentration and concentration of non-bank financial services. There are fears that banking and financial concentration through multinational foreign banks may hamper the effectiveness and competition of banking and financial market affecting the economic development of the country.

The Mexican banking industry has experienced some important changes in the last two decades. In 1982 Mexico faced fiscal deficit to meet its foreign debt and had difficulties in accessing foreign financing. The option was to nationalize the local banking industry and forced the new nationalized banks to concentrate their business in investing and lending to the public sector. The expropriation of Mexican private banks in September of 1982 was taken on the grounds that had excessive profits, concentrated banking operations and created monopolistic practices and markets and facilitated capital flight (Unal & Navarro1999). In the context of a major macroeconomic and financial crisis, after a large period of relative stability and growth, the Mexican commercial banks were nationalized and subject to strict regulations and government controls.

Commercial banks were nationalized and subject to strict state controls in 1982 in the context of a macroeconomic crisis. Nationalized banks concentrated on investments in the public sector. 58 of 60 Mexican banks were nationalized and reorganized in 1982 merging and concentrating the commercial banking system into just 18 commercial state-owned banks. This banking concentration was significant in the three largest Mexican banks accounting for nearly 60 percent of total assets (Gruben & McComb, 1997). Banking concentrations and returns were considered the evidence that competition had been abridged, although the statistical delineation of competitive returns was difficult to estimate (Gilbert, 1984).

One of the problems that are faced by the Mexican economic development today is the concentration of the banking and financial system. According to antitrust laws, mergers leading to the formation of monopolies are forbidden by the Mexican Federal Constitution to prevent fair competition. The Federal Competition Bureau (CFC) can object to mergers and acquisitions and impose restrictions and divestitures among banks and financial institutions when the level of concentration may be harmful to the economy. The CFC evaluates any merger and acquisition using the Herfindahl-Hirschman index (HHI).

Mergers and acquisitions have to be authorized by the Ministry of Economy after considering the opinions of the Banco de México (Banxico), the central bank and the Banking Commission (Yacamán, 2001). Some economic policies limit the concentration in the banking industry. The factors to evaluate the potential impact of a merger or acquisition are the institutional soundness, industrial structure and performance of authorities. Institutional soundness is related to solvency and economic viability of the merger. The identification of markets impaired by the merger and its potential impact on competitiveness is relevant to assess the structure of industry. Mergers may hinder the abilities of financial institutions affecting supervision of the financial system, conduct monetary policy and regulation of the payment system.

This chapter is based on an index to obtain more precise information in order to determine the effects in the structure of banking sector, after the process of mergers and acquisitions. Bank mergers are considered a vehicle for improving the financial structure and efficiency of the banking industry.