

# research snapshot

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## Bank Mergers May Have Negative Effects on Customers

### What is this research about?

A loan involves one party lending funds to another, in return for future interest payments and a return on investment. The two parties will negotiate the terms of the contract, which include the interest rate, the time until the loan matures, and whether or not collateral is needed. A syndicated loan is a corporate loan made by a group (or syndicate) of banks and other institutional investors. Occasionally, large banks will have more demand for loans than they can offer to customers, and smaller banks will have more funds on hand than they can profitably lend. As a result, large banks will grant a loan to a firm and then sell portions of it to a syndicate of other banks. (Each member of the syndicate will set up a separate contract with the borrower). One or more lead banks, responsible for giving out the loan, will head each loan syndicate.

Canadian banks have become major participants in syndicated loan markets. In these markets, borrowers include both major corporations and smaller private companies. But what determines the structure of bank loans? And how do mergers – the joining of two or more companies – affect the wealth of their shareholders?

### What you need to know:

People who have recently been dwelling on – and trying to justify – personal behaviour that they think is unethical or personally damaging should be aware that their thinking, even on other unrelated tasks, might be impaired.

### What did the researcher do?

Gordon Roberts, a Professor at York University, set out to explore how stock markets in Canada and the U.S. react to changes in both the structure and financial health of banks. He looked at bank mergers and also tested the relationship between loan maturity and interest spreads. He used the LPC Deal Scan database to examine loan deals from 1988 to 1998.

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### What did the researcher find?

The researcher found that shareholders benefit when Canadian banks acquire other smaller financial institutions, especially if the institutions are direct competitors. However, mergers may benefit shareholders in banks at the expense of reduced competition and higher prices to customers. In other words, bank mergers may have negative effects. And mergers between financial institutions in different areas may not be feasible.

The researcher also looked at how the structure of loan syndicates controls possible conflicts of interest between the lead banks and the other participating banks. If not well controlled, such conflicts could increase risk in the banking system. He also found that banks currently price loans effectively to control risk. This will benefit bank regulators who are responsible for putting into place new international bank capital rules.

### How can you use this research?

Regulators and academics in finance will find this research useful. Bank loans represent an important and growing source of corporate financing. As a result, more research is necessary to further understand the structure of corporate loans.

### About the Researcher

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### Keywords

Banks, Loans, Loan syndicates, Mergers, Syndicated loan markers

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### Knowledge Mobilization at York

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