

# Special Feature

## Financial Services M&A - Asia's frenzied deal environment increases the risk of overpaying

The surge of M&A activity seen in Asia's financial services industry in 2006 is likely to gather force over the next five years as firms both within the region and from the West continue to look to Asia as the "home of growth". The impact of this focus on Asia is already being felt in the form of intense competition for a limited supply of quality assets, higher prices and the spread of activity to more countries across the region – and indeed to more sub-sectors of financial services. Based on data from M&A Asia, M&A in the sector (including insurance) skyrocketed by 66 percent to US\$64.5 billion in 2006 from US\$38.8 billion in 2005. In this article, we highlight the trend of the financial services M&A activities in Asia.

## The Trends

### *Price has become a concern*

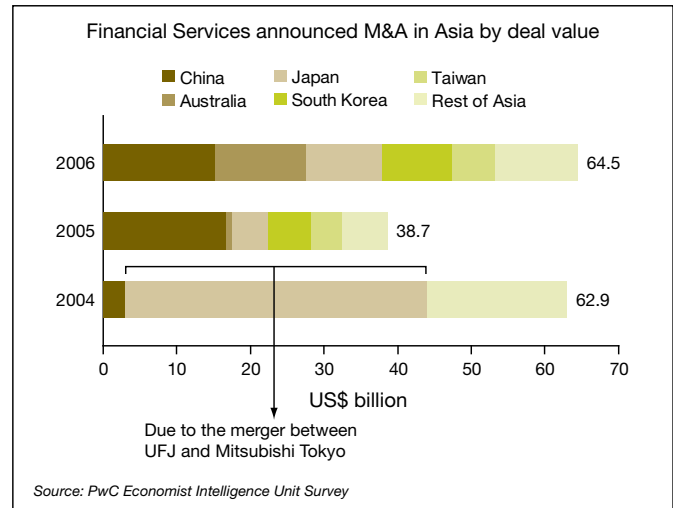
In a recent PwC survey on the Financial Services M&A activities in Asia, half of all survey respondents cited high pricing, a significant rise when compared to almost one-third (32 percent) of respondents in 2005, is the principal barrier to undertaking M&A activity from a company point of view – a clear sign that competition for deals is intensifying. Rising prices have, however, brought more deals on to the market – the number of respondents citing lack of attractive targets as a barrier to M&A dropped from 52 percent in the same survey in 2005 to 34 percent in 2007. Concerns about value for money will undoubtedly lead some organisations to put more emphasis on organic growth plans.

### *Financial services institutions are casting the net wider*

Both China and India remain crucial markets for financial services companies looking for growth and, barring radical shocks, are likely to remain so for years to come. However, other markets are beginning to compete for capital and attention: Taiwan and Malaysia are considered ripe for consolidation, while others such as Vietnam, Indonesia and Pakistan are attracting those interested in emerging economies.

### *Activity in the insurance sector is increasing*

Asia's insurance sector has been particularly active and a key driver in terms of M&A overall with deal value almost doubling over the last year, from US\$4.4 billion to US\$13.5 billion. One deal in Australia, Suncorp Metway's purchase of Promina Group, accounted for a large proportion of the increase at just under US\$6 billion. But excluding this deal activity was still up by 72 percent. The trend is being driven by the desire of Western insurers to catch up with the market leaders and by Japanese insurers moving abroad.



### *Liberalisation is less of a driver*

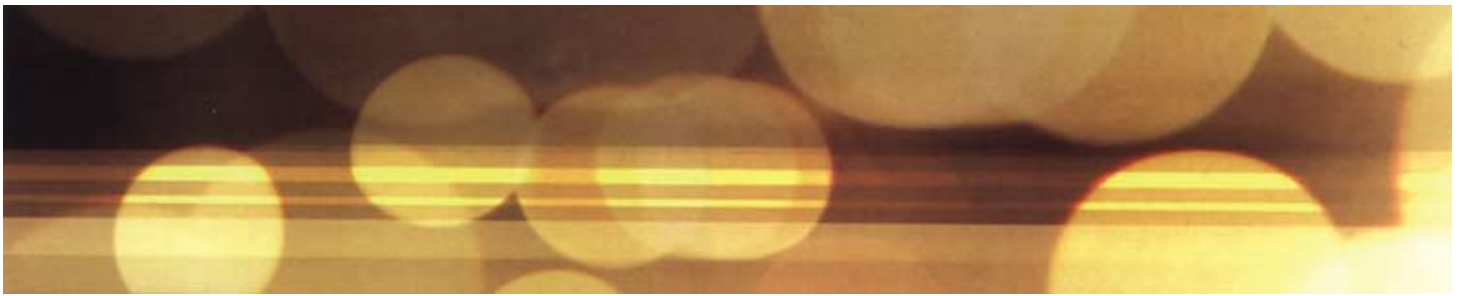
Regulatory liberalisation is considered less of a driver of M&A in part because there are signs of regulations easing across the region, particularly in smaller markets. Indeed, regulatory pressure to restructure or merge in some markets, such as Thailand, is acting as a positive influence and is considered a more significant driver than in previous year. Asia's financial services industry is learning to live with the current regulatory environment, or at the very least, putting more emphasis on growth.

## Coming Out On Top

Competition for deals in the financial services sector in Asia is expected to intensify and prices are likely to be driven ever-higher as a result. How can companies navigate this environment and come out on top?

### *Examine prices carefully*

As prices rise and previously unavailable targets suddenly show interest in selling, the temptation to pay more than normal circumstances would warrant will be ever greater. With today's relatively high prices, it is more important than ever for buyers to weigh deals carefully in the context of strategic goals and to fully price synergies. For example, China and India, for all their imperfections and still unfolding regulatory regimes, are simply too large an opportunity to ignore and conventional methods of pricing will often need to be tailored to fully reflect the overriding strategic objectives and the opportunity cost of deferring an investment decision.



In most cases, however, growth assumptions should be critically analysed—any number of global shocks, from a global economic slowdown to political turmoil to a major natural disaster could throw growth prospects off track, further increasing the risk of over-paying.

#### *Find a balance between organic growth and M&A*

Some people believe that organic growth is an extremely important strategy for achieving most corporate goals, and it is likely to increase in importance as prices rise. M&A, while providing opportunities for rapid growth, is distracting and often poorly executed—and carries even more risk in an over-heated market. While gaining an early foothold in an emerging market via acquisition of a minority stake will almost certainly pay future dividends, with today's relatively inflated prices, it will be necessary to carefully weigh the benefits and drawbacks in the context of each individual market.

#### *Be prepared for competition from regional players*

While the largest western financial services companies have provided the most competition for Asian assets in the past, regional companies, notably from Japan and China, are expected to take a very active role in the market in the coming years. This is already beginning to happen in the insurance sector and the trend has implications for the nature of competition. Japanese companies, for example, take a different approach to valuing assets and are generally willing to wait longer than their Western counterparts for a deal to pay off.

#### *Build capability and capacity*

The enormous shortage of human capital in Asia's financial services sector is a major inhibitor of growth—both organic and inorganic. The shortage is not confined to Asia and is likely to worsen as institutions from emerging markets begin to compete for talent. Clearly, strong management will become an increasingly important source of competitive advantage and those companies that have prioritised the development of their management team will be best placed to capitalise on growth opportunities.

## Outlook

Interest in Asia's financial services sector will only increase, going forward. Asian institutions, having grown rapidly in recent years, are now seeking to expand beyond their borders, posing a new form of competition for traditional players, namely Western institutions. For example, Japanese institutions are beginning to expand their footprint to a size that is commensurate with their asset and customer bases.

The strategies of Chinese institutions for the rest of Asia have yet to become clear, but they too have the scale to become regional, and perhaps one day, international, players. Singaporean banks are already active in the region and there is the prospect of more players emerging.

Adding to the frenzied environment is the prospect of further opportunities opening up – as barriers to foreign investment in the financial services sectors of India and Malaysia are lowered after 2009 and 2010, respectively.

As prices continue to rise and the already scarce supply of quality targets begins to look overpriced, more institutions will opt to put emphasis on organic growth and collaboration. But organic growth alone is unlikely to be enough to bring the kind of rapid expansion many are looking for, or to offer an effective reply to the aggressive plans of the world's financial services giants.

Although growth might be shifting in terms of key markets, Asia is still the 'home of growth'. When compared to Europe or the US, entry into the Asian market presents more of a challenge as the environment is less conducive to control deals, which in turn increases the risks if you are not able to find the right partner. Although this risk in Asia remains high, the growth potential will continue to present compelling opportunities.

To explore these factors in more detail, see our recent publication: "Financial Services M&A – Going for Growth in Asia 2007", available for download at [www.pwc.com](http://www.pwc.com)

