

Corporate accounts



This paper explores the possibility of a merger or acquisition between two leading banking institutions in the United Arab Emirates. While the two terms may be used interchangeably, their meaning is different. Mergers are rare occurrences whereas acquisitions are common. The paper looks at each bank and the strength it commands in the market. For the sake of this hypothetical merger two banks have been selected. These are: The Abu Dhabi Islamic Bank and The Dubai Islamic bank. Both institutions trade in the same region and have a similar range of products. The assumption here is that Abu Dhabi Islamic Bank is being acquired by Dubai Islamic Bank. In addition to what the two banks have in common, one factor stands out clearly; they are in the business of Islamic Banking.

Islamic banking differs from conventional banking in the following ways:

It is based on religion and follows the principles laid out in the Quran.

Conventional banking does not follow any religious principles but operates on banking laws. Islamic banking allows Halal activities. Any business ventures forbidden by the Quran e. g. liquor and gambling are not dealt with.

Conventional banks finance any business venture. Interest or Reba is prohibited. All activities undertaken by Islamic banks are devoid of interest. Instead, Islamic banks earn through fees and profits from their activities which is then shared among customers. This is not the case in conventional banking system where banks charge interest as well as give it to customers.

Keywords: merger, synergy, acquisition, net income

Abu Dhabi Islamic Bank

Abu Dhabi Islamic Bank is a public company founded in 1997. Following the Amiri Decree, the bank opened for business in 1998. The bank operates under the Sharia Islamic principles offering products and services with a bias on the teachings of Islam. At the time it commenced operations, ADIB had a capital base of 1 billion Dirhams divided into 100 million shares of 10 Dirhams each. These shares are quoted on the Abu Dhabi stock exchange market. The key products include: personal banking for individuals, business banking for business people and wholesale banking for corporates. Its subsidiaries include: Burooj Properties, ADIB securities, Kawader Services and National Bank for Development based in Egypt. ADIB has a branch network of 66 branches all over UAE. ADIB: Mission & Objectives

Dubai Islamic Bank

Established in 1975, Dubai Islamic Bank is a financial institution offering banking and financial services based on Islamic principles. It is regarded as the pioneer financial service provider to incorporate Islamic based banking practices. DIB is a public company with shares listed in the Dubai Stock Exchange market. The bank has a network of 62 branches in UAE. Its subsidiary, DIB Pakistan Limited has 75 branches in Pakistan, an office in Jordan and Turkey. Dubai Islamic Bank. Wikipedia

Mergers and Acquisitions

Assuming that Dubai Islamic Bank wants to acquire Abu Dhabi Islamic bank

Why was the decision taken?

What were the reasons behind the decision, and what are the consequences?

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How will each company benefit from the decision?

A merger involves the combination of assets and liabilities of two firms to form one business unit. The term acquisition applies to the situation where a small firm is absorbed by a larger one. Merger refers to firms that have approximately equal financial strength. For the sake of this assignment, a hypothetical merger is proposed between DIB and ADIB. It will involve the issue of new shares to shareholders of the target firm. Mergers and Acquisitions. QuickMBA. com

Reasons for the merger decision

Undervalued firms

ADIB shares may be trading at an undervalued price in the stock exchange market. By acquiring this bank DIB would gain a surplus emanating from the difference between the current market price and purchase price. Assuming the current unit share price at the financial markets is 75 Dirhams while the actual price is estimated at 100 Dirhams, the acquirer will make a surplus of 25 Dirhams per share which is a profit. Motives for acquisition. n. d.

Diversification with an aim of reducing risk

Diversification reduces an investor's risk. " By buying firms in other businesses and diversifying, acquiring firms managers believe that they can reduce earnings volatility and risk and increase potential value." Motives for acquisition. n. d.

Creation of synergy

Synergy refers to the potential arising out of the combination of two firms. Through synergy, firms increase in growth and income. DIB expects to increase its revenue by serving an increased number of clients, having a diverse range of products and operating in a larger geographical area.

Motives for acquisition. n. d.

How each company will benefit from the acquisition decision

Economies of scale: the resultant firm will become profitable and cost-efficient

Improved power to price products: as a result of less competition and high market share, the combined firm will generate high incomes and enjoy high profit margins

Combined functional strength: both banks provide quality banking services in a region where Islamic banking is widely accepted. ADIB might have a stronger management team which would be an asset to DIB and vice versa.

Market growth: the merger would result in market strength and capacity to penetrate new markets

The acquisition will take the form of DIB acquiring the stock of ADIB. The shareholders will be paid in the ratio of stock held.

The net income of the acquired company in the year 2010 was 1.087 billion AED. The purchasing company will be awarded 1.086 billion AED being the amount attributable to equity holders of the bank. (ADIB: Annual Report. Consolidated Income Statement, year ended 31 December 2010, page 50)

“ Under the equity method of accounting, an equity investment is initially recorded at cost and is subsequently adjusted to reflect the investor's share of the net profit or loss of the associate.” [IAS 28. 11]

Intercompany transactions will only involve a swap of shares. Shareholders of the associate will be issued with new shares of the parent company. There is no exchange of cash since the equity method of acquisition is being applied.