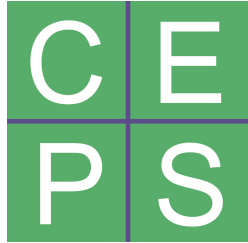


Mergers and acquisitions in European banking: Overview, prospects and future research

Presented at EUMOptFin3: The drivers of performance of
large financial institutions
Bergamo, 17-21 May, 2004

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Policy Studies (CEPS)*



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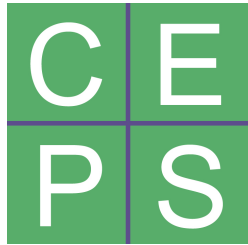
- Main characteristics of the M&A wave on the 90s in the EU
- Key Drivers
- Overall assessment
- Prospects
- Research in progress



Main characteristics of the recent wave of M&As in European banking (1)

Sample and methodology elements

- 151 M&A transactions in banking in the EU 15 (120 domestic and 31 cross-border)
- Complete mergers or majority acquisitions exceeding the threshold of 49% of voting rights.
- Targets and acquirers are banking institutions as defined in the second banking directive
- Statistical analysis performed on the number, total value and average value of the transactions



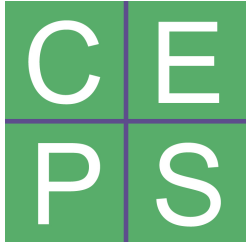
Main characteristics of the recent wave of M&As in European banking (2)

Acceleration of M&A activity since 1996

- Upward trend of the number of the transactions
- A steady growth of the annual value of the transactions

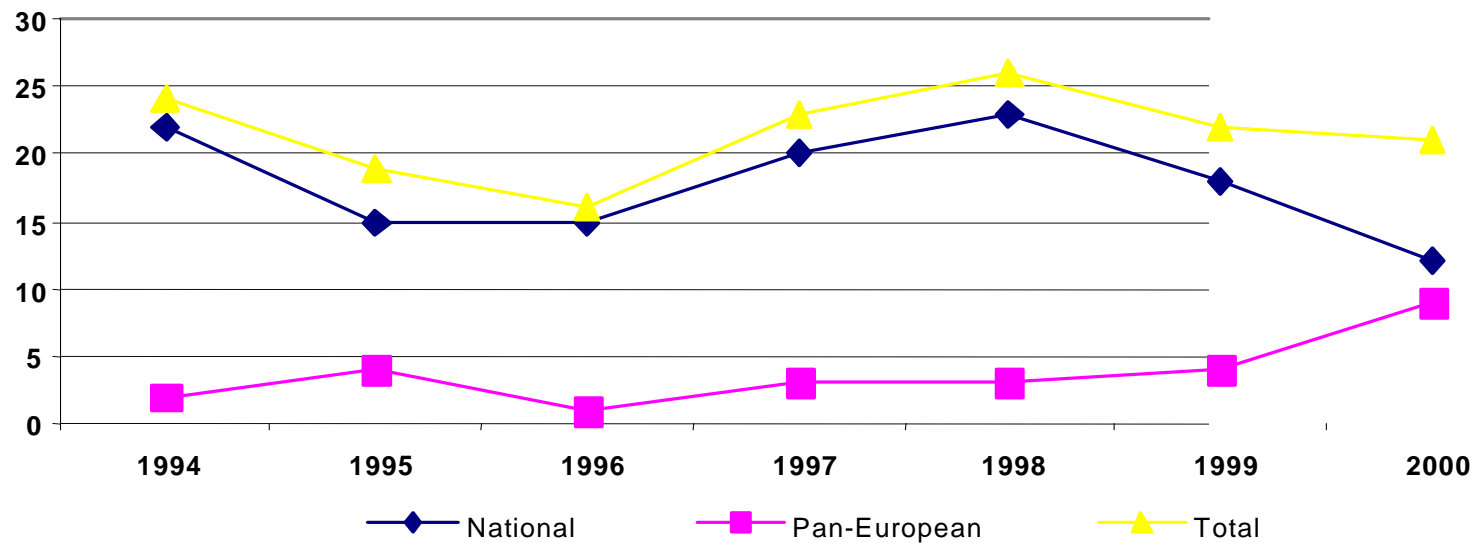
A global slowdown of M&A activity since 2001 following the overall downturn in the financial markets

M&A Activity seems to peak up since the beginning of 2004



Main characteristics of the recent wave of M&As in European banking (2)

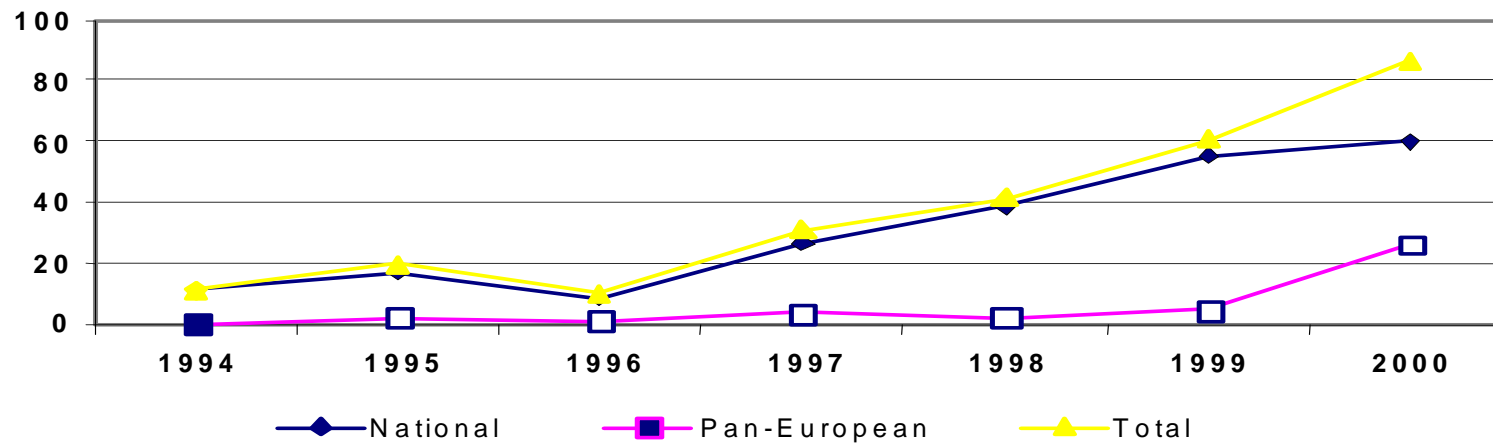
National vs. pan-European banking M&As, by number (1994-2000)





Main characteristics of the recent wave of M&As in European banking (2)

National vs. pan-European banking M & As, by value (1994-2000)

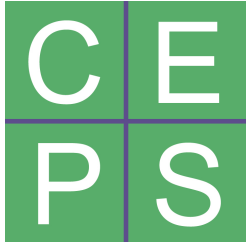




Main characteristics of the recent wave of M&As in European banking (3)

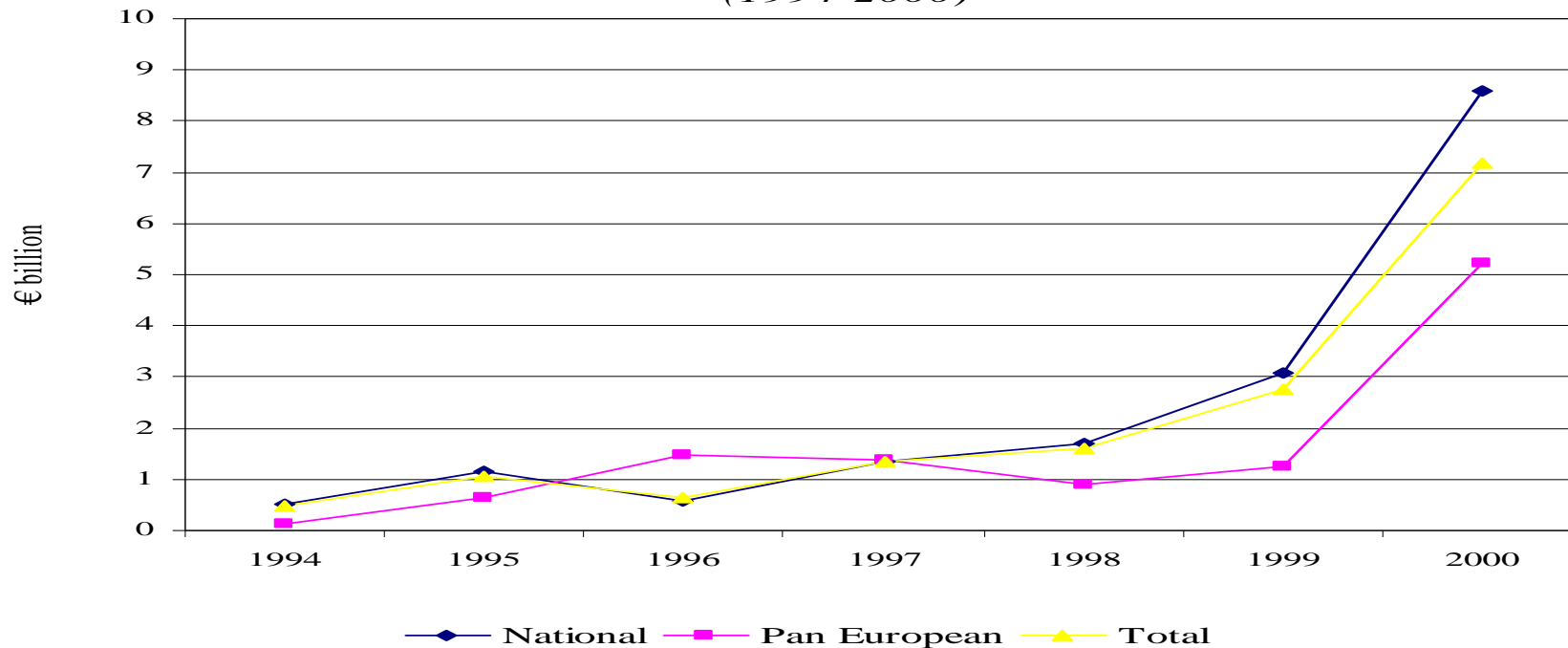
Emergence of mega-banks at national scale since 1999 (BNP Paribas in France, SCH et BBVA in Spain, Intesa BCI et Unicredit in Italy, RBoS in the UK.....)

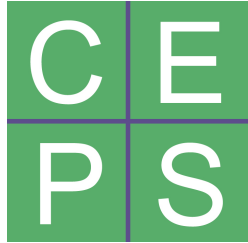
- A continuing growth of the average value of the transactions reaching a peak in 2000



Main characteristics of the recent wave of M&As in European banking (3)

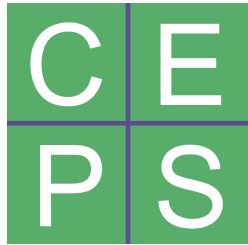
National vs. pan-European banking M&As by average value (1994-2000)





Main characteristics of the recent wave of M&As in European banking (3)

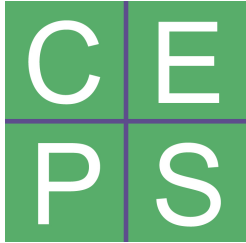
- Two hypothesis could be mentioned to explain the significant increase in the average value of the transactions:
 - Either this increase is due to a few large transactions, in that case, the concentration process is dominated by few large banking institutions;
 - Or it is a consequence of a widespread concentration process affecting the whole banking industry.



Main characteristics of the recent wave of M&As in European banking (3)

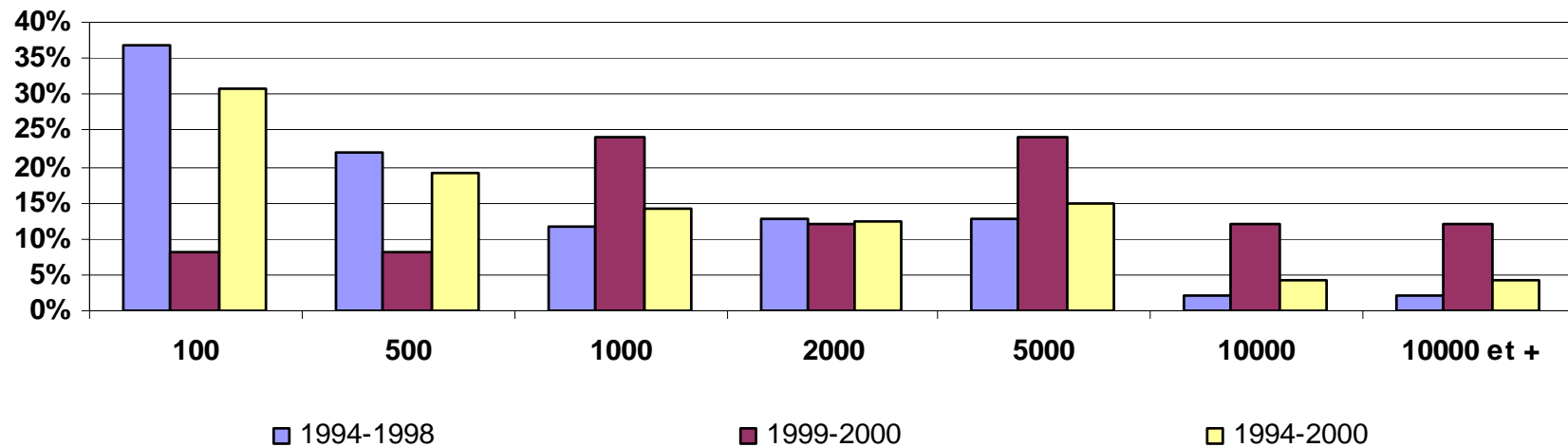
The distribution per period indicates that the banking concentration process in the EU experienced two successive stages over the period 1994-2000. The first completed in 1998 was dominated by small and medium sized transactions suggesting the desire to reduce excess capacity. Over 1999-2000, a major change occurred where 85% of the transactions were medium to large sized. The distribution per year confirmed these results.

The concentration process in European banking in the 90s was structural, profound and dynamic.



Main characteristics of the recent wave of M&As in European banking (3)

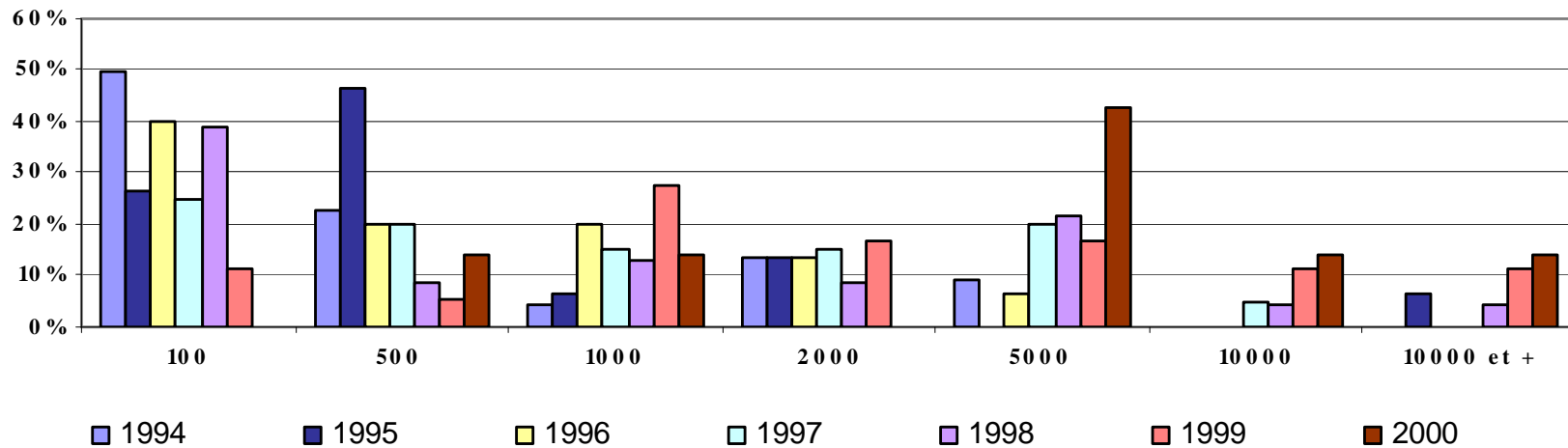
Changes in domestic M&A banking distribution per period

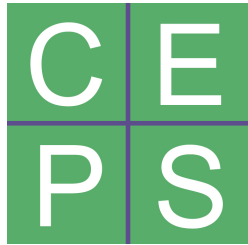




Main characteristics of the recent wave of M&As in European banking (3)

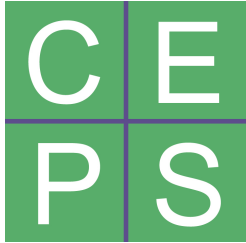
Changes in domestic M&A banking distribution per year





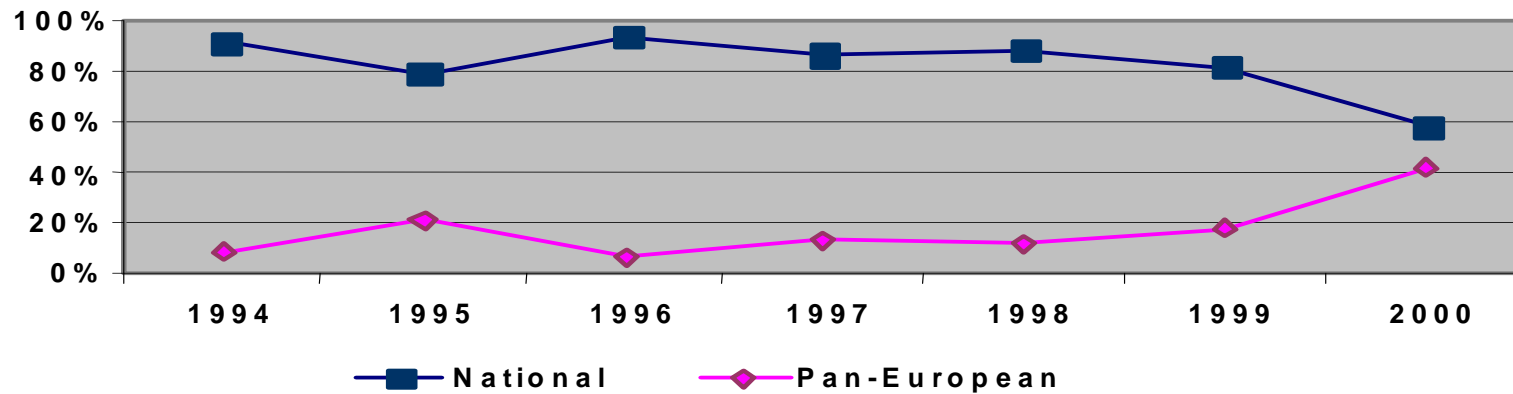
Main characteristics of the recent wave of M&As in European banking (4)

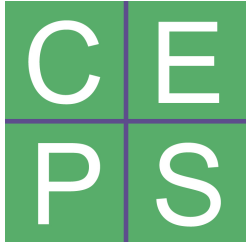
- A timid development of cross-border transactions at AU level
 - Predominance of domestic M&As in European banking throughout the period, but a marked increase can be observed in cross-border transactions starting in 1999.
 - Increase of the acquisitions in emerging areas offering high potential growth and new opportunities for development such as in Eastern Europe, Latin America and in the US.



Main characteristics of the recent wave of M&As in European banking (4)

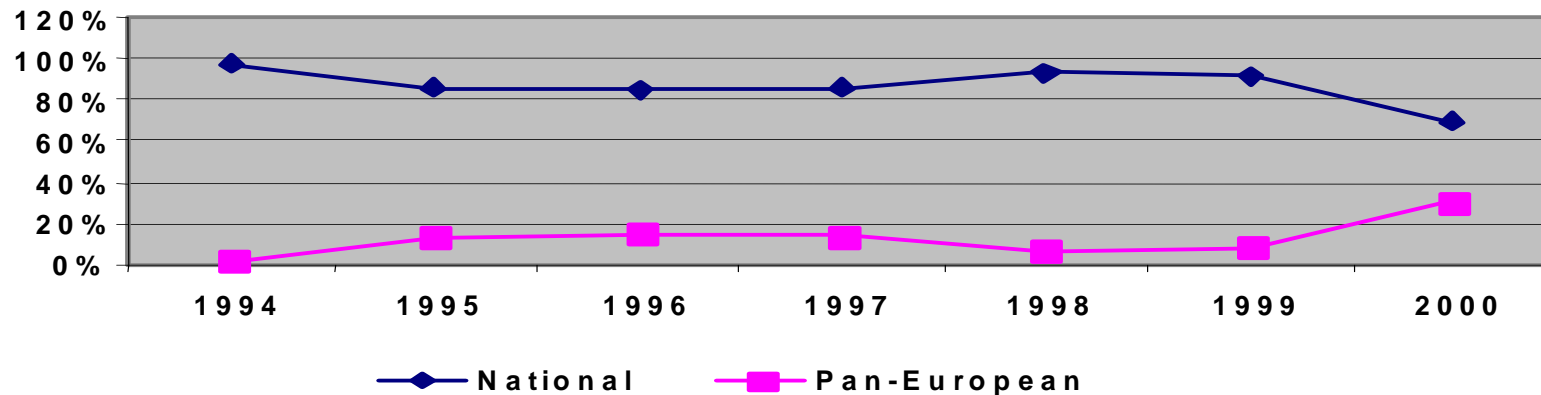
Comparison of national vs. pan-European banking M & As, by number (1994-2000)





Main characteristics of the recent wave of M&As in European banking (4)

Comparison of national vs. pan-European banking M & As by total value (1994-2000)





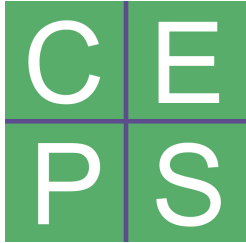
Main characteristics of the recent wave of M&As in European banking (5)

- Towards the constitution of European financial conglomerates
A relative importance of cross-industry transactions (insurance and investment firms)

The distribution of targets and acquirers industries in 1999
(in Billions \$)

Acquirer	Target	Banks	Securities	Insurance companies	Total
		89	9	20	118
Banks		36,03%	3,64%	8,10%	47,77%
	Securities	23	19	24	66
		9,31%	7,69%	9,72%	26,72%
Insurance companies		11	6	46	63
		4,45%	2,43%	18,62%	25,51%
Total		123	34	90	247
		49,80%	13,77%	36,44%	100%

Source : DeLong, Smith & Walter – Securities Data Company (2000).



Key drivers of banking M&As (1)

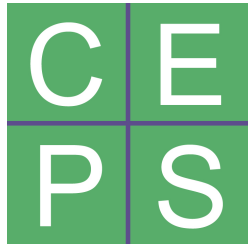
- The leading role of the environment
- Value-maximising motives
 - Enhanced market power
 - Greater efficiency
- Other motives
 - Managerial motives
 - Mimicry effect
 - Defensive reaction



Key drivers of banking M&As (2)

Main characteristics of a typology of industrial strategies through M & A in E U banking

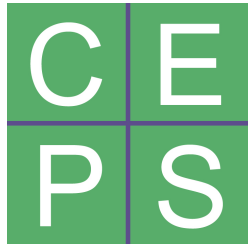
	National M & A			Cross-border M & A			
Geographical dimension	National consolidation National M & A National consolidation National diversification			Pan-European diversification Pan-European M & A Cross-border diversification		International diversification International M & A	
Activity segment or business	Same activity, same business	Same activity, different businesses	Different activities	Same activity, same business	Same activity, different businesses	Same activity	Different activities
<i>Types of industrial strategy</i>							
Industrial strategies	National consolidation (business)	National diversification (business)	National and conglomerate diversification	Business consolidation and cross-border diversification	Business diversification and cross-border diversification	Activity consolidation and international diversification	Conglomerate and international diversification
<i>Motivations related to the strategies adopted</i>							
Motivations resulting from M & A operations	Increase of the market power in a given market	Reduced risk due to the diversification of activities (of the income), and the extension of the activity into another geographical area	Scope economies through diversification of the held portfolio	Attaining an important size in a cross-border market	Diversification of risks and incomes	Attaining a larger size in a cross-border market	Scope economies and diversification of risks



Overall assessment of M&As in European banking:

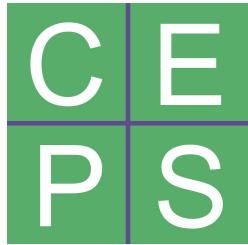
What economic effectiveness?

- Value creation : still not conclusive results
 - *Event studies (effects of M&As on stock market values) mixed results*
 - *Efficiency remains contested and controversial topic*
 - *Economies of scale (size-efficiency) seems to be exhausted at relatively small output levels, in Europe research yielded mixed findings*
 - *Economies of scope (product-mix efficiency) little consensus, but apparently also exhausted at very low levels of output*
 - *X-efficiency (operational-efficiency) generally much larger than scale efficiencies and scope-efficiencies, or ‘banks can improve their overall cost efficiency to a greater extent if they emulate the banking industry’s best practice than by increasing size (scale) or diversifying (scope)’ (Berger 1999)*



Overall assessment of M&As in European banking: What economic effectiveness?

- Empirical findings to be manipulated with caution:
 - *Most empirical research undertaken in US banking market, not necessarily transposed in the EU (different regulation and structure)*
 - *Time period insufficiently long after an M&A to obtain reliable results*
 - *Striking differences between domestic and cross-border M&As, and the intrinsic characteristics of the operation (hostile, friendly..)*
 - *Data conformity and limitations of econometric tools*
 - *difficulties in the post integration process*
 - *Managerial hubris : is it a relevant piece of explanation?*

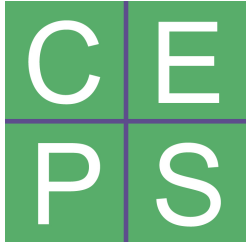


Overall assessment of M&As in European banking: What economic effectiveness?

Improvement of collective welfare: little consensus

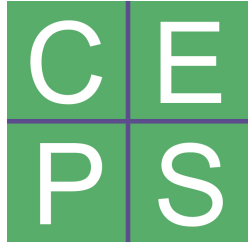
- *Domestic (increase of market power?) / cross border (increase in competition?)*
- *Market power (a simple profit redistribution in favour of shareholders) / efficiency (a possible pass-on to consumers)*

Impact on the quality of banking services: geographical availability, financial access and technology integrated into the service: major role of new technologies



Overall assessment of M&As in European banking: banking M&As and growth?

- M&As may strengthen the soundness and the stability of the banking sector:
 - *The threat of a possible takeover by a competitor urges banks to be more competitive*
 - *Reduction of excess capacity has a positive impact on profitability*
 - *M&As constitute a natural selection mechanism through the rationalisation of banking supply structure*



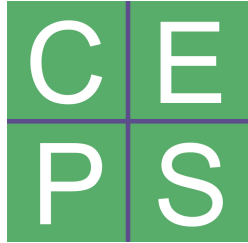
Overall assessment of M&As in European banking: banking M&As and growth?

- ... But the emergence of mega-banks may create a new source of fragility:
 - *The extension of application of too big to fail rule and the exacerbation of the moral hazard phenomenon*
 - *May jeopardise financial stability and cause competitive disruption*



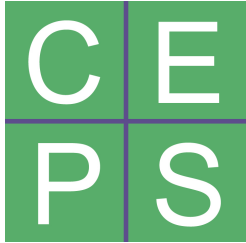
Overall assessment of M&As in European banking : impact on market structure?

- Overall increase in concentration levels in almost all EU15 banking markets. Significant differences continue to exist, however, across countries:
 - *In some countries, concentration raises anti-competitive concerns*
 - *In others, a highly fragmented banking market*
- Concentration indicators to be manipulated with caution,
 - *What relevant market?*
 - *The degree of contestability of the market*



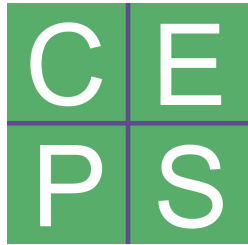
Overall assessment of M&As in European banking : impact on capacity?

- M&As may perform disciplining function against cost inefficiencies and excess capacity through (job-cuts and branch closure)
- But, other factors may also explain the capacity reduction
 - *Emergence of call centres and e-banking leading to the rationalisation of banking branch network (Scandinavian countries)*
 - *In southern Europe, the trend is different owing to the local characteristics of these countries (dual structure of their banking sectors)*



What prospects (1) Banking consolidation in the medium-term

- Different patterns of consolidation in European banking:
 - *In countries where concentration threshold admitted by the competition authorities is reached, cross-border consolidation could be the alternative to external development (Scandinavian Countries, and Benelux)*
 - *In countries where concentration levels are intermediate, some specific scaled M&As are expected at domestic level and growing interest to cross-border acquisitions (France, Spain, and UK)*
 - *In countries where concentration level are relatively low, further domestic consolidation is expected at a first stage (Germany, and Italy)*

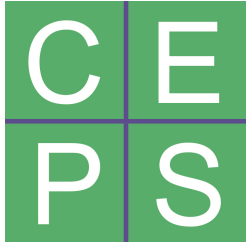


What prospects (1) Banking consolidation in the medium-term

- Cross-border consolidation in the medium term leading to the emergence of cross-border European financial groups

Until now the majority of cross-border M&As were confined to geographical areas with strong historical and cultural links

Nordea, HVB-Bank Austria, RBoS-Natwest, Dexia...



What prospects (1) Banking consolidation in the medium-term

- Remaining cross-border consolidation barriers in Europe:
 - *Still high level of public ownership of banks*
 - *Non-economic motives ('national flagships')*
 - *Remaining large number of co-operative savings banks*
 - *Present labour rigidities and problem of staff reduction*
 - *Regulatory barriers (national regulations on mergers can act to protect domestic interests from foreign competition...)*



What prospects (1)

Banking consolidation in the medium-term

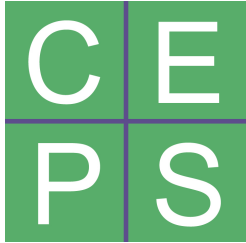
- Initiatives to promote the the full integration of banking and capital markets in Europe:
 - *FSAP is a step forward to ensure the full integration of banking and capital markets*
 - *Extension of Lamfalussy procedure to banking*
 - *The progress made in the New Basel Capital Accord*
 - *Reform of the European Community Merger regulation*
- Reducing the regulatory burden and hence facilitate cross-border growth opportunities



What prospects (2)

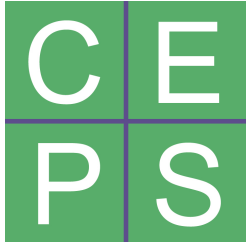
Towards which banking model in Europe?

- The recent consolidation wave together with the regulatory developments have blurred the boundaries between financial activities and contributed to the enlargement of the range of activities proposed by the major European banks
- Whereas universal banking model has prevailed as a reference in the past, two trends have emerged following the recent consolidation wave

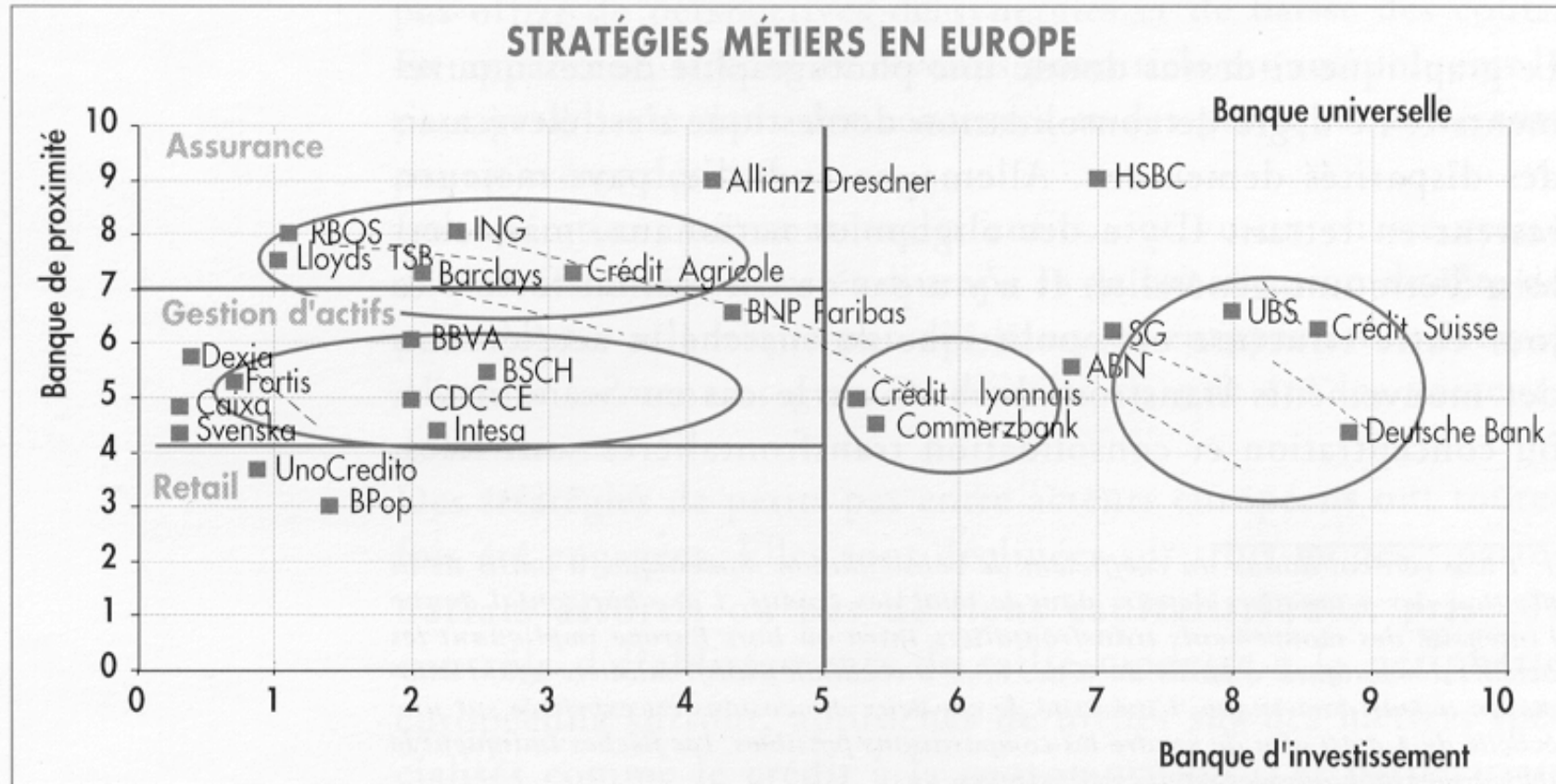


What prospects (2) Towards which banking model in Europe?

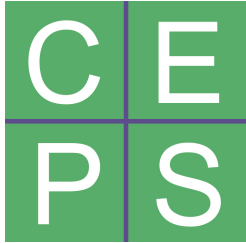
- On one hand, emergence of *global investment banking*, highly concentrated (following few targeted acquisitions) on a world-wide scale and specialised in few activities (Deutsche Bank, Crédit Suisse Group, UBS,)
- On the other hand, the multi-specialised banking institutions or *universal retail banking*, heavily involved in retail businesses and considered to be a dominant model in Europe.



What prospects (2) Towards which banking model in Europe?

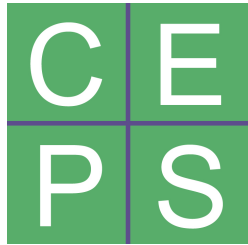


Source : CA S.A.



What prospects (2) Towards which banking model in Europe?

- The development of universal banking is justified by the benefits of diversification, but it is not the only possible business model, specialised banking model is also beneficial. This specialisation can take two dimension:
 - *It can be functional when covering an individual activity or customer segment*
 - *Or geographical through the knowledge of a specific geographical area*



What prospects (2)

Towards which banking model in Europe?

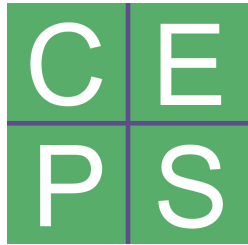
- It is difficult to choose between the alternatives of diversification and specialisation. Universal and specialised banking institutions will continue to co-exist, each one having its characteristics and responding to individual needs.
- One of the objectives of banking consolidation is to reconcile the advantages of diversification specific to universal banks with a search of a better specialisation



What prospects (2)

Towards which banking model in Europe?

- Optimum size : a controversial question
 - *Empirical research concluded that a larger size is not synonym of a higher profitability.*
 - *A larger scale may increase the risks of bureaucratisation, and inefficiencies*
 - *In the future, although many banking activities will be increasingly dependent on a larger size, it more the product mix and the targeted customer that will determine the optimum bank size*



Research in progress (1)

Assessment of M&As in European banking in the 90s

- Based on the sample of 151 M&As in banking
- Typology of M&As according to the “business strategy involved the day of the announcement ”
- Dynamic efficiency analysis on sub-samples having the same characteristics
- Application of DEA methodology
 - *Produce efficiency scores*
 - *Compare efficiency score before and after a merger*
- Additional *Regression analysis (Logit model)* to explain changes in efficiency scores after the merger