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# 1

## Why Study M&A in Banking?

### 1.1 Introduction

This book deals with the analysis of Mergers and Acquisitions (M&As) in the European banking markets. One might address the following four questions:

1. Why a book on M&A?
2. Why banks?
3. Why in Europe?
4. Is it necessary to have another contribution to the M&A debate?

With regard to the first question, the M&A is an important phenomenon worldwide. M&A deals are the two most visible expressions of the functioning of the corporate control market. These are often perceived by companies' stakeholders (and, especially, by workforce) as dramatic events since the ownership of an entire company changes hands in a single transaction. In a merger deal, two separate companies agree to combine and form a single corporate entity rather than remain separately owned and operated. This is done by issuing stock of the controlling corporation to replace most of the other company's (or companies') stock.

In some cases, a company acquires all the assets and liabilities of another firm, which ceases to exist after the merger is completed, and retains its name and often most of its top management. In other cases, two separate companies create a completely new firm and both firms cease to exist. In acquisition deals, a company (labelled

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as “bidder”) acquires control of another firm (labelled as “target”) by stock purchase (i.e. either through an agreed-upon deal or a hostile takeover) or stock exchange. Acquisitions are also known as takeovers and usually involve big companies acquiring a smaller one. Although Merger and Acquisition refer to different concepts, these terms are often used interchangeably.

The volume of M&A transactions has boosted over the last few years. According to the Thomson Financial (2007), the volume of worldwide M&A declared during 2007 reached US\$4.5 trillion in announced deals and US\$3.8 trillion in completed deals – that is, 24% increase over the previous record set in 2006. From 2000, the volume of M&A deals has increased by 32%, despite the fall off during the third quarter of 2007 caused by concerns in the credit markets. The M&A phenomenon concerns all countries worldwide (see Table 1.1): in 2007, M&A deals increased by 25% in North America (reaching a volume of almost US\$2.0 trillion over 2007 – that is, 52% of M&A deals value worldwide), by 18% in Europe (reaching a volume of almost US\$1.3 trillion over 2007 – that is, 34% of M&A deals value worldwide) and they strongly increased also in the Asian-Pacific area by 61% (reaching a volume of almost US\$0.4 trillion over 2007 – that is, 10% of M&A deals value worldwide). Regarding the type of deals, the M&A cross-border activity accounted for 47% of worldwide

*Table 1.1* Worldwide completed M&A in 2007

Region	Rank value (in USD billion)	No of deals	Change in rank value (in %)
America	1,979.3	11,567	27.1
North America	1,862.1	10,575	24.7
Central America	49.7	181	404.7
South America	58.1	707	41.3
Caribbean	9.3	104	-26.3
Africa/Middle East	39.9	443	-27.6
Asia – Pacific	378.4	5,504	61.1
Europe	1,298.7	9,915	18.2
Eastern Europe	112.4	1,212	21.1
Western Europe	1,186.3	10,575	18.0
Worldwide	3,784.1	28,729	23.9

*Source:* Thomson Financial (2007, p. 3).

activity in 2007 as global consolidation continued to drive activity in various sectors.

Why banks? This book analyzes the M&A phenomenon focusing on the banking industry since the consolidation in that industry was particularly important worldwide. Although the growth of the consolidation process concerns almost all industries,<sup>1</sup> most deals take place in the financial, materials and energy power industries. In banking, the consolidation process is particularly important: in 2007, M&A transactions among financial institutions worldwide were more than 7,000 for an overall value of more than USD 700 billion (see *Thomson Financial*, 2007, p. 2).

Regarding the third question, the M&A phenomenon is particularly remarkable in the European banking. While over the 1990s most M&A transactions involved North American banks and the European banking consolidation process was minor, the number and the value of deals within the European banking industry has currently a magnitude similar to that of the US banking (see Figure 1.1). Namely, in terms of number of transactions completed over 2005, the European financial institutions were involved as targets for 32% of transactions (EU-15 banks account for 27%) and for 31% of transactions as acquirers (EU-15 banks account for 28%). In terms of value of the deals completed over 2005, the European financial institutions were involved for 40% of transactions as targets (EU-15 banks account for 36%) and for 36% of transactions as acquirers (EU-15 banks account for 32%).

These data provide evidence that the M&A phenomenon is particularly relevant and it is thus an important research area. Given the importance of the M&A phenomenon, this is one of the most investigated areas in finance. To have an idea, we simply searched the Google scholar website ([www.scholar.google.com](http://www.scholar.google.com), accessed on 16 May 2008) and found 14,800 papers showing the term “Merger and Acquisition” in the title and 53.600 papers having the word “M&A” quoted in the title. We also searched the Amazon website (<http://www.amazon.com>, accessed on 16 May 2008): 4,314 pieces of works quote “M&A,” 23,803 researches include “Merger and Acquisition.”

These data lead us to ask one final question: is it necessary to have another contribution to the M&A debate? May further studies on these topics add to the existing literature? In our opinion, they may do so. Previous books deeply analyzed the M&A phenomenon with

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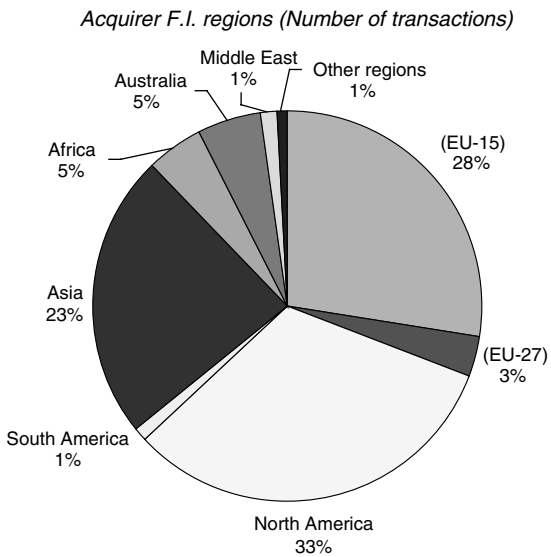
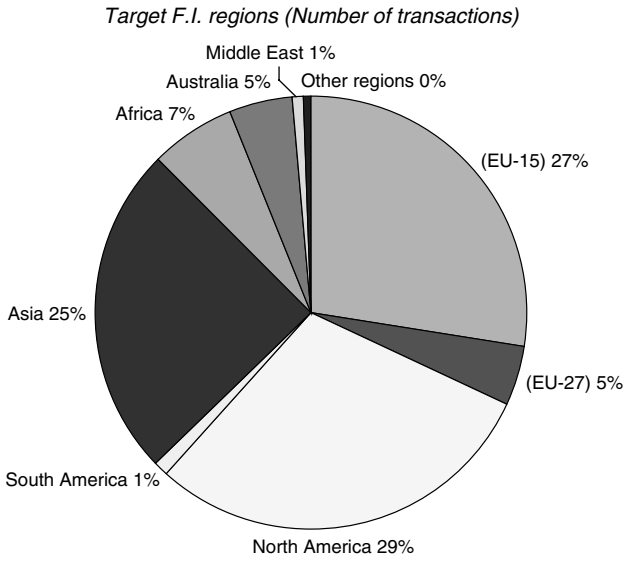
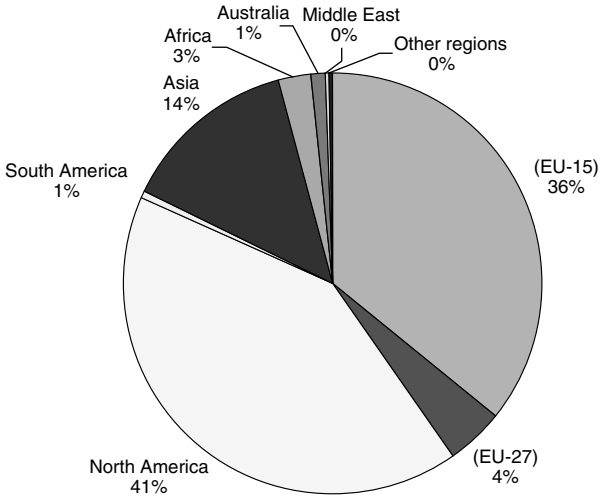


Figure 1.1 Continued

Target F.I. regions (Overall value of transactions)



Acquirer F.I. regions (Overall value of transactions)

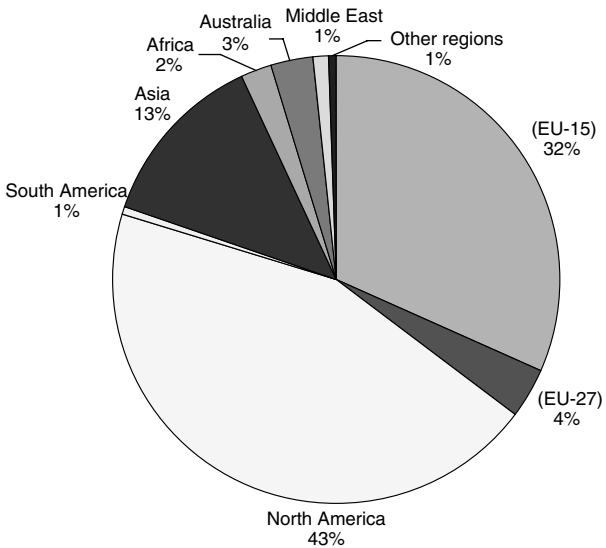


Figure 1.1 Number and value of M&A deals among financial institutions in 2005 for country regions

Source: Thomson ONE Banker database.

regards to management, organizational structure, corporate finance, taxation issues, especially in the US market. Our book aims to advance prior literature focusing on some specific aspects, which have been investigated by only limited number of studies. Namely, this text proposes an independent assessment of the effect produced by M&A transactions on bank efficiency and shareholder value. M&A deals have usually been justified to increase the company efficiency and, finally, create shareholder value, but few studies have analyzed the overall result of M&A deals to support these motivations, especially in the European banking.

In final, we searched the Amazon website using the words “bank” and “Europe” with “M&A” either “Merger and Acquisitions” to verify the number of books dealing with this topic. Overall, we found 15 pieces of work having also “M&A” in the book description and 16 having also “Merger and Acquisition” jointly with “Europe” and “Bank.” This research comprises some books, but also special issues of academic journals and digital books. On the whole, we found that none of these was a specific research within European Banking aiming to verify the effects produced by M&A transactions on bank performance and check if M&A motivations have been really achieved.

## 1.2 Structure of the text

The book combines various investigation methods including business cases (a review of the most recent M&A cases), the event study methodology and the stochastic frontier methods to assess the effects (both in the short and medium term) of M&A deals on banks' shareholder value and efficiency. It is organized into nine chapters. In Chapter 2, we provide a framework for analyzing the M&A phenomenon by discussing some peculiar features of the European banking industry and analyzing recent trends of the consolidation process. Since the 1990s some of the most important M&A deals worldwide have involved European banks (for example, there have been six big mergers from 2006 for an overall value of more than 170 euro billion) and M&As are certainly one of the main bank responses to higher competitive pressures in European banking. New forces of changes are mainly related to structural deregulation and prudential reregulation, competition enhancement, technology developments, globalization, and so forth have occurred. Especially, regulatory changes

played a major role; that is, the structural de-regulation and prudential reregulation processes.

In Chapter 3, we answer to a simple question: why do banks merge? While it is evident that European banks have increasingly merged over the 2000s, these operations have various motives. Generally, M&A deals aim to create shareholder value and, among all possible drivers, we discuss revenue enhancement, cost reduction and new business opportunity reasons. We also analyze seven cases of big merger deals in European banking: the Royal Bank of Scotland (leading a consortium comprising also Fortis and Banco Santander) and ABN AMRO in 2007, the Unicredit bank and Capitalia in 2007, BNP Paribas and Banca Nazionale del Lavoro in 2006, the Unicredito Italiano and Bayerische Hypo und Vereinsbank in 2005, Banco Santander Central Hispano and Abbey National plc in 2004, HSBC Holdings and Crédit Commercial de France in 2000.

In Chapter 4, we review the literature dealing with the M&A phenomenon in the financial service industry. Although the number of studies is very large, there is a mixed evidence about the M&A effects on the participating financial firms, bank customers and societal risks. Overall, studies investigating the M&A effect over the medium-long term in European banking are more homogenous than the US banking. They show that M&A deals lead European banks to enhance their performance and productive efficiency. However, the number of studies investigating the M&A effect on operating performance (especially in Europe) is limited and it is not possible to draw definite conclusions.

Next, we make various empirical investigations in order to measure the effect produced by M&A transactions. Namely, analyzes of M&A deals in both the short term by using the event study analysis (see Chapter 5), and the medium-long term by estimating bank's efficiency and shareholder value changes (see Chapters 6 and 7, respectively) are provided. In Chapter 5, we run an event study finding that M&A deal created, on average, substantial shareholder value for the target companies, while the estimated mean Cumulative Abnormal Returns (CAR) for bidder companies are, on average, negative. The analysis of the combined entity provides evidence that the "entire" M&A transaction created (taken as a whole) shareholder value, rather than simply transfer wealth from the bidder banks' shareholders to the shareholders of the targets.

In Chapters 6 and 7, we analyze the M&A results in the medium and long term by comparing the levels of efficiency and the value created by banks in a moment that precedes M&A operations to those obtained in a following moment. In the light of the results obtained, the M&A operations analyzed do not seem to have had very significant results on the efficiency of European banks: on a time horizon of five year, the acquiring bank improves its efficiency of 0.67% on average, while the bank resulting from the merger seems to face an average worsening of 0.54%. In terms of value created for shareholders, the effect produced by M&A operations seems to be better: the relative capacity of creating value (given by the ratio between EVA and invested capital) increases by 0.23% in the five year following the operation of aggregation in case of acquisitions and of 0.41% in case of mergers. Further contributions to the analysis on this theme may focus on the analysis of possible benefits in terms of the opportunity cost of the capital invested by banks in consequence of M&A operations, which may determine, *ceteris paribus* – a higher capacity of creating value.

Finally, we analyze the post-acquisition integration phase in Chapter 8. Banks often fail to achieve the expected M&A benefits because of the bad management of the post-acquisition phase. Every acquisition target has unique benefits (for example, operating scale economies, geographical coverage, access to technology, management talent) and each of them is valued differently by individual stakeholders. As such, the integration of two merging banks involves the integration of the banks' systems, processes, procedures, as well as of strategy, reporting system, incentives and, especially, of people. Conclusions are in Chapter 9.

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