

Travel abroad or stay at home?

Investigating the patterns of bank industry M&As in the EU

Catarina Figueira, Joseph Nellis and Richard Schoenberg

School of Management, Cranfield University,

Cranfield, Bedfordshire MK43 0AL, United Kingdom

Tel: +44.1234.751122; Fax: +44.1234.752136

About the authors

Catarina Figueira is a Research Fellow at Cranfield School of Management, previously at the Scientific and Technological Options Assessment Division at the European Parliament. Areas of expertise include international financial integration and efficiency of financial services. *E-mail: Catarina.Figueira@cranfield.ac.uk*

Joseph Nellis is Pro-Vice Chancellor of Cranfield University and Professor of International Management Economics. Areas of expertise include economic and business environmental analysis and strategy formulation. *E-mail: j.g.nellis@cranfield.ac.uk*

David Parker is Professor in Business Economics at Cranfield School of Management. He is a specialist in strategic management, particularly in the area of mergers and acquisitions. *E-mail: Richard.Schoenberg@cranfield.ac.uk*

Travel abroad or stay at home?

Investigating the patterns of bank industry M&As in the EU

Word count: 5,933

Keywords: EU banking, consolidation, cross-border M&As

Type of manuscript: General review

Abstract

Purpose – This study investigates the extent of bank industry consolidation across the European Union, the patterns that have emerged from the M&As and the regulatory framework that underpins these processes. It identifies the key challenges that have to be addressed if M&As are to expand.

Design/Methodology/Approach – The paper reviews the reasons that have led some financial institutions to merge, both domestically and cross-border, and the developments that have taken place in the economic, legal and political environment. The paper presents an empirical analysis of bank industry M&As within the EU between 1993-2004 and identifies possible explanations for the patterns of consolidation.

Findings – The analysis provides evidence that M&As predominantly take place at the national level and that two main strategies have emerged, namely the consolidation of commercial banking and the creation of universal banking groups.

Research limitations/implications – Ten countries joined the EU in 2004 and are excluded from the analysis, due to data limitations.

Practical implications – More cross-border mergers should be encouraged if EU countries are to continue to integrate their financial markets. Moreover, if universal banking groups do not succeed in exploiting the economies of scope on which they are founded, divestment of non-core activities may follow, thus providing acquisition opportunities for others, with the resulting more focused organisations wishing to diversify geographically, via cross-border M&A.

Originality/value –The study suggests that the limited cross-border M&A activity observed may be due to the existence of non-legislative barriers, such as internal control issues raised by geographic diversity and, more specifically, the perceived cultural barriers to pan-European operation.

Introduction

Over the last two decades, the structure of the banking industry with the European Union (EU) has undergone significant re-shaping. This has been driven by a number of factors including the integration and globalisation of financial markets, the proliferation of new financial products and services, the innovative processes by which they are delivered (particularly e-commerce), as well as the 1986 European Commission's programme aimed at the establishment of a single market (Nellis *et al.*, 2000). As a result, banks face important challenges in order to survive and remain competitive, not only in their home markets, but also more and more, internationally. Among the trends that have been emerging in the European banking industry, evidence suggests that the industry is going through an intensified phase of Mergers and Acquisitions (M&As) activity (Lindblom and von Koch, 2002). Nevertheless, as demonstrated by Hamoir *et al.* (2002), Europe's banking system is still notably fragmented and consists of approximately 15,000 institutions. These developments have raised considerable debate among policy makers, academic strategists and practitioners as to what should be the way forward and the role played by M&As in the restructuring of European banking (Dermine, 2000).

This paper investigates the extent of consolidation in the banking industry that has taken place across the European Union, the patterns that have emerged from the M&As and the regulatory framework that underpins these processes. The structure of the paper is as follows: in section 2, we briefly highlight the dynamics driving the developments of the EU bank industry. Section 3 describes the process of consolidation in the EU and the reasons that have led some financial institutions to merge. Section 4 discusses the developments that have taken place in the economic and political environment, as well as the changes in the legal framework, which have been crucial in providing the basis for deregulation and integration of

banking systems. Section 5 concentrates on the discussion of the differences between domestic M&As and their cross-border counterparts, as well as the motives that lead institutions to embark on international activities. Section 6 analyses the data on banking industry M&As within the European Union over the period 1993-2004. The paper concludes with a discussion of the main findings and possible explanations for the observed patterns of consolidation.

Dynamics of the EU bank industry

The EU bank industry finds itself in a mature phase of its life cycle with implications for growth and pressures on margins. The process of consolidation through M&A activity is one response of the industry to such challenges. However, before examining this process in some detail, it is important to recognise that other opportunities for growth and improved margins exist. These include strategic alliances and organic growth (Johnson *et al.*, 2005). While these are not the focus of this paper, it is important to acknowledge their significance with respect to the dynamics of the industry. We comment briefly on these alternative developments routes below.

Strategic alliances are a well-recognised route to growth and, for some organisations, may be more attractive than one based on an acquisition strategy (Dyer *et al.*, 2004). In the context of EU banking, strategic alliances are becoming increasingly important as a response to competition from traditional players (i.e. existing banks) and from non-traditional providers of credit (such as retailers ranging from grocery multiples to furniture stores). Such partnerships with some non-traditional players have become an important source of revenue growth in recent years. One of the most publicised alliances has been that between Tesco, the leading UK supermarket chain, and the Royal Bank of Scotland (RBS). This alliance has

created a range of new business opportunities, in terms of growth and profitability, for both partners and has helped to support the diversification strategy of the supermarket chain. Alliances of this nature have been widely adopted between banking and a number of complementary industries (other examples are BNP Paribas and Carrefour, Bank of Scotland and Sainsbury's, to name but a few).

An alternative route to development is that based on organic growth (Ghoshal *et al.*, 2000), embracing a range of internal developments within individual banks, which tend to focus on the cost side of operations (Johnson *et al.*, 2005). Such developments include improvements in the accuracy of information flowing between frontline and back office staff, the use of shared services such as the establishment of call centres and centralised administrative support units, as well as greater emphasis on improved risk management on the lending side. The efficacy of these measures is evidenced by the significant reduction in banks' cost-to-income ratios¹.

In addition to these alternative growth routes, it should be appreciated that there are other dynamics taking place within the EU, with direct implications for the banking industry. These include the aging of the population, which can be expected to generate opportunities for new product and service developments. In addition, the greater mobility of people within Europe, resulting directly from the establishment of the Single European Market and the expansion of the EU itself, will also enable banks to expand their customer base. Finally, the scale of the "unbanked" section of the EU population has been recognised as a key strategic issue for banks. Responses to this have been catalysed by the growth in electronic payment systems and the need to minimise the cost of service provision. (Hogarth *et al.*, 2005)

Having briefly reviewed alternative routes of development, we now concentrate on the causes and consequences of M&A activity within the EU banking industry.

The process of consolidation in the EU banking industry

Following the wave of M&As in the USA in the 1980s, the European banking system has been experiencing an intensified phase of consolidation, particularly since the early 1990s (Lindblom and von Koch, 2002). The number and volume of M&As has increased significantly with the establishment of Economic and Monetary Union (EMU) (Altunbas and Ibáñez, 2004). While *cross-border* mergers are still relatively infrequent, with the exception of Scandinavia and the Benelux countries (Boot, 2003), *within-country* mergers have taken a prominent role in the banking system and have generally involved large universal banks, such as the cases of: the Union Bank of Switzerland and Swiss Bank Corporation, National Westminster Bank with Royal Bank of Scotland and Paribas with Banque National de Paris.

Reasons for M&A activity

In a constantly changing competitive environment, which results from the increasing depth of integration and globalisation of financial markets, financial institutions turn more and more to mergers and acquisitions to ensure the survival and/or growth of their businesses. The decision to consolidate should, in principle, be motivated by the desire to increase shareholder value, however agency conflicts between shareholders and managers can give rise to opposing motives for M&As (Berger *et al.*, 1999). As suggested by Brouthers *et al.* (1998), the reasons for consolidation can be underpinned by economic, strategic and personal motives. The interaction and the potential for conflict between these motives are highlighted in Figure 1 below.

[Take in Figure 1]

The desire to improve the financial performance of an institution is central to the economic argument for M&As. Specifically, this can be usually translated into measures taken which aim at reducing costs, through rationalisation and taking advantage of economies of scale, or increasing revenues and profitability, through economies of scope or the transfer of particular value creating capabilities (Walter and Barney, 1990).

The second purpose for the M&A decision is undoubtedly related to the particular strategic vision of the individual players involved. Hence, a firm may undertake an acquisition in order to enter a new geographical market, or to diversify away from its core business by entering a new product sector, or to increase its penetration of an existing market or product sector. In the latter case, acquisition of an existing competitor may serve to increase the firm's overall market power, as well as to create entry barriers (Ingham *et al.*, 1992). Companies may also be strategically motivated to undertake an acquisition because they wish to strengthen their existing resource base in a specific area, or because they lack a particular competence that would be needed to develop their strategy by internal means.

Finally, personal motives may also be one of the driving forces for the unification of some banks. Mergers have often been associated with the possibility that managers may disregard, to a certain extent, the interests of stakeholders, as suggested by Lev (1983). According to Roll (1986), managers perceive mergers as an opportunity for their salaries to increase as a result of the potential increase in sales. Moreover, the fact that managers will then need to oversee the operations of a larger company can also represent a new challenge for them, with the opportunity to boost their personal career and status (Berkovitch and Narayanan, 1993).

Even when one or more of the above motives are strong, the M&A decision may be constrained by external influences, as highlighted in Figure 1. The economic environment and regulatory framework need to be conducive to the creation and operation of the resultant

entity. To place these external factors in context, we describe below the developments that have taken place in the EU in recent decades.

Developments in the economic and regulatory environment

Since the 1957 Treaty of Rome, the need to transform a highly segmented Europe into an integrated one has been recognised. Since then, several steps have been taken towards deregulation and harmonisation of banking regulations. In 1973, the Council of Ministers adopted a directive on the abolition of restrictions on freedom of establishment and freedom to provide services for self-employed activities of banks and other financial institutions (Directive 73/183, EEC). In 1977, the first banking directive on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of credit institutions was also adopted (Directive 77/780/EEC). However, it was the principle of freedom of circulation of goods, services, people and capital, formalised by the completion of the European Single Market in 1993, that made it possible for all financial institutions in the EU to establish branches and to offer cross-border services in other member countries, as long as they were authorised to do so in their home country. This provided the basis for what is nowadays known as the *universal banking* model (Nellis *et al.*, 2000), thus transforming the way in which banking activities have since been conducted.

Another important step towards European integration within the EU has been the adoption by 12 EU members of the Euro and therefore, their adherence to EMU. This has had a number of important implications for the banking industry. For example, it has changed the structure of the corporate bond and equity markets because savers were now able to diversify their portfolio across EMU members, without having to consider exchange rate risk. In addition, it has also changed the approach by institutions to the management of credit risk. Potential

asymmetric shocks may affect economies differently and the policies of the European Central Bank may not always suit all member countries. Therefore, this potentially requires the need for international diversification of loan portfolios.

At the national level, the regulatory framework is generally regarded as well-developed, providing the necessary tools to assess M&As. However, cross-border M&As often require the accommodation of differences in accounting rules and in taxation policy. Further consideration also needs to be given to prudential rules and practices (Hamoir *et al.*, 2002). The *Financial Services Action Plan* was adopted in 1999 by the European Commission as an attempt to deal with such issues. The intention of this plan is the development of the legislative and non-legislative frameworks in order to foster an optimal single financial market, underpinned by up-to-date prudential rules and adequate supervision.

Furthermore, the 2004 Basel II Accord, which is aimed at international convergence of capital measurement and capital standards, set out new minimum regulatory capital requirements for banks (Kanbay, 2005). These requirements have been established in an attempt to minimise potential risks faced by the financial system in periods of economic turbulence (Caruana, 2005; Claessens *et al.*, 2005). The new standards may promote mergers between banks in an attempt to strengthen the capital adequacy of the participants.

Issues confronting cross-border M&As

Despite the range of measures that have been put in place to facilitate the integration of EU financial markets and the efforts to diminish the difficulties that financial institutions face when opting for cross-border business, there remain crucial differences in the establishment of within-country and cross-border M&As. In this context, it is important to highlight the

significance of regulatory and management issues, as well as the motivational aspects that give rise to cross-border M&As.

The regulatory context

The progressive harmonisation of banking legislation across EU countries has been an important step towards the facilitation of deals between financial groups of different countries (Flier *et al.*, 2001). However there still remains the risk of supervisory arbitrage and therefore the process of M&As across borders requires continuous monitoring to ensure a level playing-field.

Another point to take into account is the need for supervisory authorities to monitor capital adequacy, as sometimes this may be relaxed in order to focus on the needs of shareholders, which may lower the merger's capacity to withstand financial difficulties.

Moreover, in many cross-border M&As, it is common practice that the main institution operates in the other countries in the form of subsidiaries (Rangan, 2000). It is therefore important that the "host" authority supervises the subsidiaries on a consolidated basis and is governed by general rules.

Management issues

Related to these regulatory issues, cross-border M&As also raise a number of internal management matters. These are related to control, to the understanding of new national cultures, necessary for the enhancement of market know-how, and to the internal cultural

compatibility compounded by national cultural differences. We comment on each of these below.

In terms of managerial control, mergers and acquisitions, particularly across borders, increase the complexity of a firm's operations through the enlarged scale and scope of its activities. This complexity makes the management of a bank's financial and operational risk more difficult and calls for increasingly sophisticated internal control mechanisms. Related to the issue of managerial control is the selection of appropriate organisational structure. For example, a centralised structure may facilitate the monitoring of internal risk and the capture of scale economies, but, relative to a decentralised form, may fail to provide the necessary awareness of and responsiveness to local market conditions.

In addition, the understanding of national cultural contexts is also crucial to the success of cross-border M&As. National diversity remains a notable feature of the European business environment, where differing national cultures and heritages have produced business practices and consumer characteristics that vary considerably from one nation to another (Nicoll and Schoenberg, 1999). These differences in national contexts may make it difficult to capture revenue enhancement from cross-selling opportunities and, furthermore, may limit the ability of managers from one national market to understand the precise elements necessary for successful operation in another national market (Newman and Nollen, 1996).

Finally, it is important to consider how the corporate cultures and the employees of the two financial institutions will partner to create synergies (Olian, 2002). Research on domestic acquisitions has highlighted that differences in organisational culture and managerial approach between the two combining firms can result in increased employee stress, reduced work performance and other integration difficulties, which may ultimately lead to an inferior acquisition outcomes. These issues may be compounded in cross-border acquisitions, which,

in addition to possible differences in organisational culture, may also involve the combination of personnel and capabilities that are characterised by differences in language, national culture, and institutional contexts. Indeed, a number of empirical studies have found that the greater the national cultural distance between the acquiring and acquired firms, the lower the subsequent financial performance of the cross-border acquisition (Schoenberg, 2000).

So, what motivates financial institutions to embark on cross-border business? The following sub-section discusses the main reasons for going international.

Motivation for cross-border M&As

We have discussed earlier the reasons that underpin the merging of financial institutions. There are certain circumstances however, that lead banks to opt for foreign partners. Most cross-border mergers can be explained by one or more motives involving size, scale, scope and legislative context.

The first motive for cross-border mergers is *size*, which provides the opportunity for the group to compete not only at the national, but also regional or even global level. Size is important from two aspects: in terms of the resultant size of the bank and also in terms of the size of the clients it is able to attract. Large, international banks are generally better positioned to respond to the needs of multinational clients, especially where they share a common geographic footprint.

The second motive which attracts banks to cross-border mergers is *scale*, particularly on the revenue side. A large, international bank can take advantage of a greater customer base and a larger market and can therefore enjoy economies of scale related to the increase in revenue (Boot, 2003). It should be noted that in contrast to scale economies on the revenue side, the

potential benefits with respect to cost reductions are likely to be less in the case of cross-border mergers than those that can be expected to exist in the case of within-country mergers(Altunbas *et al.*, 1997).

The physical scale of the customer base resultant from cross-border merger can also be expected to provide opportunities for the new organisation in terms of economies of *scope*, since an enlarged bank may make it viable to offer certain services such as asset management and cross-selling of strong brands (Giovanni, 2005).

The final motivation for cross-border concentration is related to the fact that further M&A activity of large banks within a country may sometimes face opposition stemming from domestic *legislation* concerning market dominance. Thus, going international may be seen as a practical and appropriate response to the potential restriction confronting banks across the EU. It is an empirical matter as to whether or not banks have or will respond to anti-trust legislation. Bearing these points in mind, we now turn to the investigation of the M&As that have taken place across EU countries since 1993.

The patterns of M&A activity – 1993 to 2004

We investigate the patterns of bank industry M&As in the EU over the period 1993 to 2004. This covers a total of 975 deals which have resulted in either a merger or an acquisition. The data have been drawn from two sources, namely *SDC Platinum* and *Datastream*. The statistical analysis reported below concentrates on M&As in which the target is a financial institution which is based in one of the 15 member countries of the EU². It is important to point out that the acquiring institution can be of non-EU origin. The analysis reported here only considers M&As which have been completed by the end of 2004 and where the value of

the M&A has been disclosed. All of the target institutions included in the analysis are from within the financial sector and fall into one of the following United States Standard Industrial Classification (SIC) categories: 60, 61 and 62. These SIC categories include commercial banks, savings banks, real estate and mortgage banks as well as investment banks.

The overall scale of M&As

Figures 2 and 3 show the total number and value of M&As that have taken place in the EU banking industry in the period chosen (1993-2004). As can be seen from Figure 2, the total *number* of bank M&As has increased significantly from a total of 41 M&As in 1993 to 83 in 2004, peaking in 2001 when 111 M&As took place. From this figure, we can also see that a considerable amount of M&A activity has taken place in the UK (for instance, in 2001, 57% of all EU banking sector M&As took place there). For practical reasons, the M&As in the remaining countries are grouped into four other categories: the first one includes the main economies of the EU (excluding the UK), comprising France, Germany, Italy and Spain³. The second category includes the Benelux countries (Belgium, The Netherlands and Luxembourg). Collectively, Greece, Ireland and Portugal constitute the third category. The countries that joined the EU in 1995 (Austria, Finland and Sweden), together with Denmark represent the last category.

[Take in Figure 2]

Turning to Figure 3, the *value* of total M&A activity increased significantly between 1994 and 1999 for some country groups and 2000 for others. There has been a notable decline in the value of bank M&A activity generally since then, following a similar pattern to the

number of deals completed. Furthermore, while the annual average number of M&As over the period considered has increased by approximately 11%, the annual amount of money involved in M&A activity has expanded by 58% over the same period, indicating that the average transaction value has increased. The contrast between the number and value of M&As may be due to one or more reasons –reflecting, perhaps, the desire by acquirers to take over larger financial institutions, or the decline in the availability of smaller targets⁴.

It is also worth noting that the number of M&As exhibits less volatility than the value of deals - see Figures 2 and 3. For example, there are pronounced peaks in terms of value in the UK in 1995, 2000 and 2004, in the other ‘core’ countries in 1999 and in the Benelux in 1998. Inspection of the underlying data indicates that these peaks are due to major M&A deals which were completed in these years. Such large deals have important implications for the banking structure in the respective nations and for the European banking industry more generally. A brief description of these major M&As is provided in Table I. It is significant that only one of these seven major deals were cross-border in nature - namely the takeover of Abbey National plc by Banco Santander Central Hispano in 2004⁵.

[Take in Figure 3]

[Take in Table I]

Figure 4 shows the magnitude of M&A activity in the EU banking system over the period, expressed as a percentage of the total market value of the EU banking sector. The figure shows that excluding two years, 1995 and 2000, the value of the M&A activity each year was less than 10% of the market value of the banking system. It will also be seen that, after a buoyant period of M&A deals, the relative scale of consolidation within the industry (as M&A activity itself is still up in terms of absolute number and value) has now faded to levels similar to those experienced at the beginning of the 1990s.

[Take in Figure 4]

This could be due to two main reasons: on the one hand, financial groups may now find themselves in a position where it is believed that there are limited opportunities for economies of scale from which they could benefit by merging with another group or, perhaps a more assertive reason, is the fact that most of the M&A activity has so far been concentrated in domestic markets – suggesting that EU and domestic regulations or non-regulatory obstacles may have discouraged cross-border deals. The following subsection analyses the levels of M&A activity both within-country and cross-border.

Within-country versus cross-border M&As

Figure 5 presents M&A activity (in terms of value), by classifying the deals into four categories:

- *within-country* M&As involving financial groups which operate in the *same* sector⁶ (intra-sector, intra-nation),
- *within-country* M&As involving groups which operate in *different* sectors (inter-sector, intra-nation),
- *cross-border* M&As from within the *same* sector (intra-sector, inter-nation) and
- *cross-border* M&As between groups from *different* sectors (inter-sector, inter-nation).

[Take in Figure 5]

From the figure, it is clear that, in most years, the majority of M&A activity takes place within countries rather than across borders (with the exceptions of 1993 and 2004). The year

1993 corresponds to the completion of the agreement on the free movement of capital within the EU, creating therefore an incentive (at least in the short run) for deals to be made across frontiers. In 2004, one of the few big cross-border mergers took place - between Abbey National (UK) and Santander Central Hispano (Spain). The fact that there have been so few cross-border M&As raises a question concerning the impact of the Single European Market legislation, the introduction of the Euro and the regulatory reforms in promoting an environment conducive to European integration, as evidenced by cross-border M&A activity. Table II highlights the sharp distinction shown in Figure 5 between within-country and cross-border deals.

[Take in Table II]

Finally, Tables III and IV present M&As disaggregated by type of bank, expressed in terms of value and number of deals respectively. Table III provides evidence to show that intra-sector M&As have dominated consolidation activity for 8 of the 12 years studied. It also shows that, in terms of value, the majority of M&As involved at least one commercial bank and, in most years over half of all M&A activity has involved intra-sector mergers between commercial banks

[Take in Table III]

However, when M&As are distributed by type of bank in terms of the number of deals completed, Table IV reveals that a growing percentage of mergers has involved institutions that concentrate on investment activities. In fact, mergers solely between investment banks or where at least one of the partners is an investment bank, have been growing in relative terms, peaking in 2001, when more than half of the total number of mergers in the EU included an investment institution.

[Take in Table IV]

It also appears from Table IV that around half of all transactions are inter-sector. In fact, inter-sector M&As accounted for the majority of activity by number in 7 out of the 12 years. This suggests that, while consolidation of the commercial banking sector accounts for a large proportion of the value of M&A activity, there is a significant number of inter-sector deals reflecting the building of universal banking groups.

The information reported in Tables III and IV would seem to support the argument that there are two strategic trends emerging in the European banking industry – one of consolidation of commercial banks and the other of growth in universal banks.

Conclusions

This paper has looked at the pattern of M&As in the EU banking system. Using data for the period 1993 to 2004, two conclusions emerge. First, the evidence suggests that the predominant strategies driving M&A activity have been the consolidation of commercial banking at the national level and the creation of universal banking groups. Secondly, it is notable that M&As continue to take place largely within national borders.

There have been some cross-border M&As, mainly in the late 1990s and in the earlier part of the current decade. These have been small in number but have tended to involve major financial groups. This appears to be mainly due to the fact that the large financial institutions have the resources to assess better the risk (and also the return) involved in operating in a foreign country than smaller players. This is further illustrated by the fact that the acquisitions that have taken place in the new members of the EU (Central and Eastern

European countries) have usually involved a major Western financial group (Figueira *et al.*, 2005).

There has been considerable change in the political, regulatory, social and economic environment within the EU in the last decade. There have been a number of drivers of change involving, for example, the establishment of the European Single Market, the expansion of EU membership, the creation of the Euro and the introduction of the Financial Services Act Plan. These have all played a role in supporting the integration of Europe's banking and capital markets. Therefore, it can be argued that significant progress has been made towards the establishment of a legislative environment that is conducive to cross-border M&As. At the same time, changes in the global regulatory framework (based on the Basel Accords) also have implications for decisions relating to bank consolidation in many countries, not least in Europe. Nevertheless, the empirical evidence reported in this paper indicates that cross-border M&As remain limited in number – more cross-border mergers must be encouraged and facilitated if EU countries are to continue to integrate their financial markets.

The cause of limited cross-border M&A activity may be explained by the existence of non-legislative barriers, such as the internal control issues raised by geographic diversity and, more especially, the perceived cultural barriers to pan-European operation. As we have indicated earlier, the latter include both national differences in consumer preferences and attitudes, which maintain the need to tailor products for individual national markets, as well as differences in national institutional contexts, which may constrain the opportunities for common operating practices.

It may be that we will see an increase in cross-border M&A over the coming years. It is reasonable to assume that it will take a number of years before the full effect of regulatory reforms is felt (such as the reforms based on the Financial Services Act Plan and the Basel

Accords). There is also a widely held perception that national cultures and the associated consumer preferences may be slowly converging across Europe. Indeed, the industry has seen some notable examples of successful pan-European product innovation in recent years (for example, ING Direct savings).

A further boost for cross-border activity may also result from the two corporate strategies that our data suggest have driven M&A activity over the past decade. The consolidation of commercial banking at the national level will, at some point, become constrained by anti-trust considerations, perhaps prompting these banks to look beyond their traditional national borders and begin the building of pan-European positions. The second strategy evident within our data is the creation of universal banking groups. At present, it appears unclear as to whether such diversified groups will succeed in exploiting the economies of scope on which they are founded. If they do not achieve their promise, divestment of non-core activities may follow, as these groups concentrate their business within a single sector. Not only would this provide acquisition opportunities for others, but the resulting more focused organisations may then wish to diversify geographically, via cross-border M&A, rather than by sector as in the past. Both of these possibilities are consistent with, and would be promoted by, cultural and regulatory convergence.

Overall, the prospect of further bank industry M&A appears high. This is not to say that M&A activity will necessarily lead to profitable growth. It is well documented that M&As are high risk, with almost half of all cross-border acquisitions failing to meet their original objectives or destroying shareholder value (Schoenberg, 2006). M&As may give institutions access to more clients but, for example, they do not always improve profit margins or the quality of the loan portfolio. Successful growth through acquisition will still require banks to

pay careful attention to maintaining a strong and differentiated customer proposition together with a competitive cost structure.

References

- Altunbas, Y. and Ibáñez, D.M. (2004) “Mergers and acquisitions and bank performance in Europe. The role of strategic similarities”, *European Central Bank Working Paper* no. 398, October.
- Altunbas, Y., Molyneux, P. and Thornton, J. (1997) “Big-bank mergers in Europe: An analysis of the cost implications”, *Economica*, Vol. 64, pp. 317-329.
- Berger, A.N., Demsetz, R.S. and Strahan, P.E. (1999) “The consolidation of the financial services industry: causes, consequences and implications for the future”, *Journal of Banking and Finance*, Vol. 23, Nos. 2-4, pp. 135-194.
- Berkovitch, E. and Narayanan, M.P. (1993) “Motives for takeovers: an empirical investigation”, *Journal of Financial and Quantitative Analysis*, Vol. 23, No. 3, pp. 347-362.
- Boot, A.W.A. (2003) “Consolidation and strategic positioning in banking with implications for Europe”, University of Amsterdam working paper.
- Brouthers, K.D., van Hastenburg, P. and van den Ven, J. (1998) “If most mergers fail., why are they so popular?”, *Long Range Planning*, Vol. 31, No. 3, pp. 347-354.
- Caruana, J. (2005) “Implementation of Basel II”, *Financial Markets, Institutions & Instruments*, Vol. 14, No. 5, pp. 253-265.
- Claessens, S., Krahen, J. and Lang, W.W. (2005) “The Basel II reform and retail credit markets”, *Journal of Financial Services Research*, Vol. 28, Nos. 1-3, pp. 5-13.

- Dermine, J. (2000) "Bank mergers in Europe: the public policy issues", *Journal of Common Market Studies*, Vol. 38, No. 3, pp. 409-425.
- Dyer, J., Kale, P. and Singh, H. (2004) "When to Ally and When to Acquire", *Harvard Business Review*, Vol. 82 , pp. 108-115.
- Estrella, A. (2001) "Mixing and matching: Prospective financial sector mergers and market valuation", *Journal of Banking and Finance*, Vol. 25, pp. 2367-2392.
- European Commission (1998) *Case no. IV/M.1172 – Fortis AG / Generale Bank*.
Luxembourg: Office for Official Publications of the European Communities.
- Figueira, C., Nellis, J. and Parker, D. (2005) "How efficient is the Polish banking industry?", *Cranfield School of Management Working Paper* no. 1/05.
- Flier, B., van den Bosch, F.A.J., Volberda, H.W., Carnevale, C.A., Tomkin, N., Melin, L., Quelin, B.V. and Krieger, M.P. (2001) "The Changing Landscape of the European Financial Services Sector", *Long Range Planning*, Vol. 34, pp. 179-207.
- Ghoshal, S., Hahn, M. and Moran, P. (2000) "Organizing for firm growth: the interaction between resource-accumulating and organizing processes", in Foss, N. and Mahnke, V. (Eds.) *Competence, Governance and Entrepreneurship*, Oxford University Press, Oxford, pp. 146-167.
- Giovanni, J. di (2005) "What drives capital flows? The case of cross-border M&A activity and financial deepening", *Journal of International Economics*, Vol. 65, pp. 127-149.
- Hamoir, O., McCamish, C., Niederkorn, M. and Thiersch, C. (2002) "Europe's banks: Verging on merging", *The McKinsey Quarterly* 3, pp. 116-125.

- Hogarth, J.M., Anguelov, C.E. and Lee, J. (2005) "Who has a bank account? Exploring changes over time, 1989-2001", *Journal of Family and Economic Issues*, Vol. 26, No. 1, pp. 7-30.
- Ingham, H., Kran, I. and Lovestam, A. (1992) "Mergers and profitability: a managerial success story?", *Journal of Management Studies*, Vol. 29, No. 2, pp. 195-208.
- Johnson, G., Scholes, K. and Whittington, R. (2005) *Exploring corporate strategy*, Seventh Edition, FT Prentice Hall, London.
- Kanbay (2005) *Effective dates for Basel II-related regulations in the US and UK: Basel II update*, Kanbay Global Headquarters, Rosemont.
- Lev, B. (1983) "Managerial incentives in mergers and their effect on shareholder wealth", *Midland Corporate Finance Journal*, Vol. 1, pp. 29-35.
- Lindblom, T. and von Koch, C. (2002) "Cross-border bank mergers and acquisitions in the EU", *The Service Industries Journal*, Vol. 22, No. 4, pp. 41-72.
- Nellis, J.G., McCaffery, K.M. and Hutchinson, R.W. (2000) "Strategic challenges for the European banking industry in the new millennium", *International Journal of Bank Marketing*, Vol. 18, No. 2, pp. 53-63.
- Newman, K. and Nollen, S. (1996) "Culture and congruence: the fit between management practices and national culture", *Journal of International Business Studies*, Vol. 27, No. 4, pp. 753-779.
- Nicoll, W and Schoenberg, R. (1999) "The reality of integration within the European Union", *Thunderbird International Business Review*, Vol. 41, No. 3, pp 273-285

- O'Brian, H. (2005) "In Italy, little hope for two foreign bank bids", *TheDeal.com*, July.
- Olian, J. (2002) "The forgotten side of corporate mergers", PennState, SMEAL College of Business *News and Media Resources*, May.
- Rangan, S. (2000) "Seven myths to ponder before going global", in *Mastering Strategy*. London: Pearson Education, pp. 119-124.
- Roll, R. (1986) "The Hubris Hypothesis of Corporate Takeovers", *Journal of Business*, Vol. 59, Vol. 2, pp. 197-216.
- Schoenberg, R. (2000) "The influence of cultural compatibility within cross-border acquisitions: a review", *Advances in Mergers and Acquisitions*, Vol. 1, pp. 43-59.
- Schoenberg, R. (2006) "Measuring the Performance of Corporate Acquisitions: An Empirical Comparison of Alternative Metrics", forthcoming in the *British Journal of Management*, Vol. 17.
- Walter, G.A. and Barney, J.B. (1990) "Management objectives in mergers and acquisitions", *Strategic Management Journal*, Vol. 11, pp. 79-86.

Figure 1: Inter-relationships in the process of M&As.

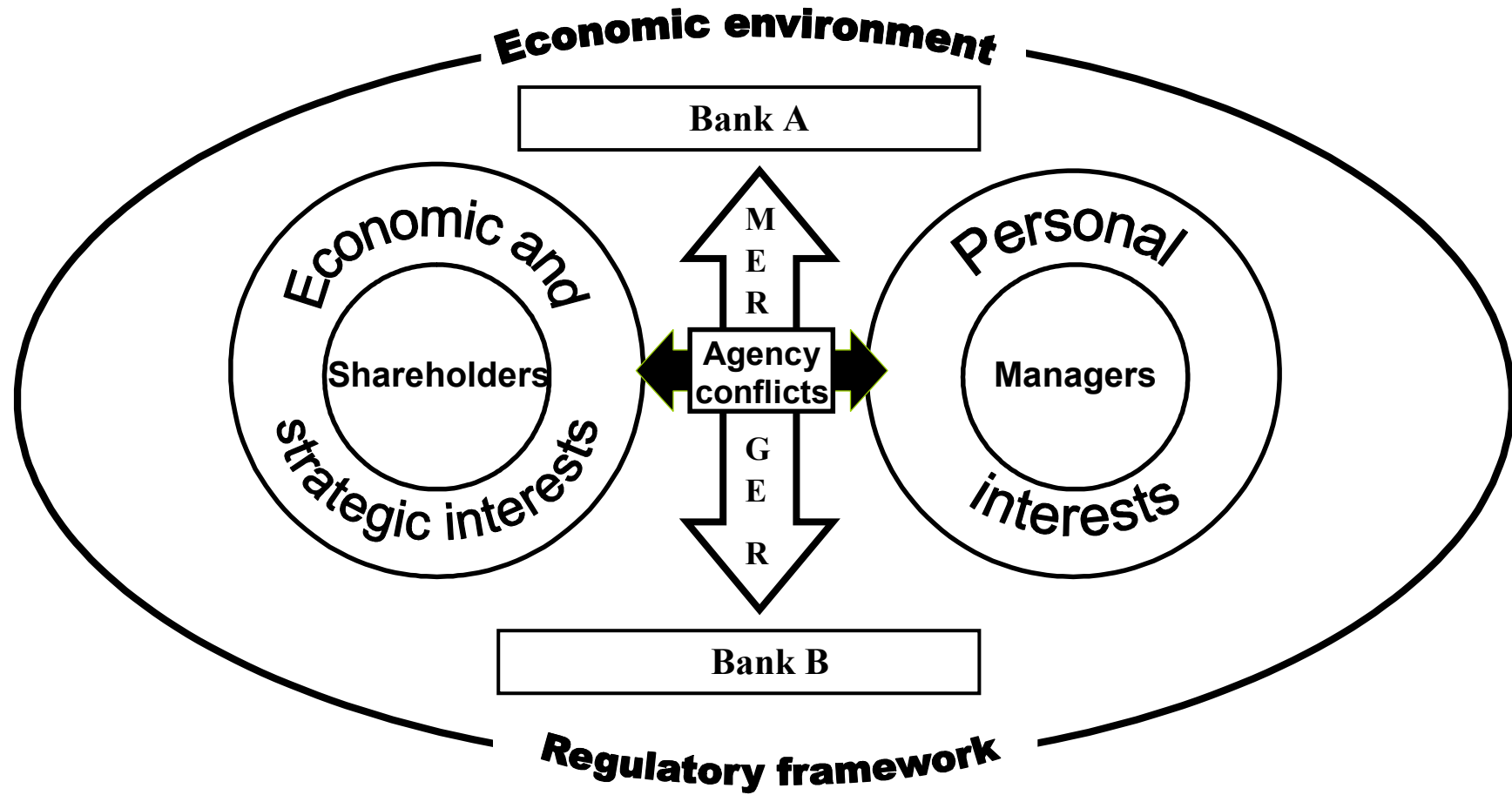


Figure 2: Number of banking M&As in the EU, 1993-2004

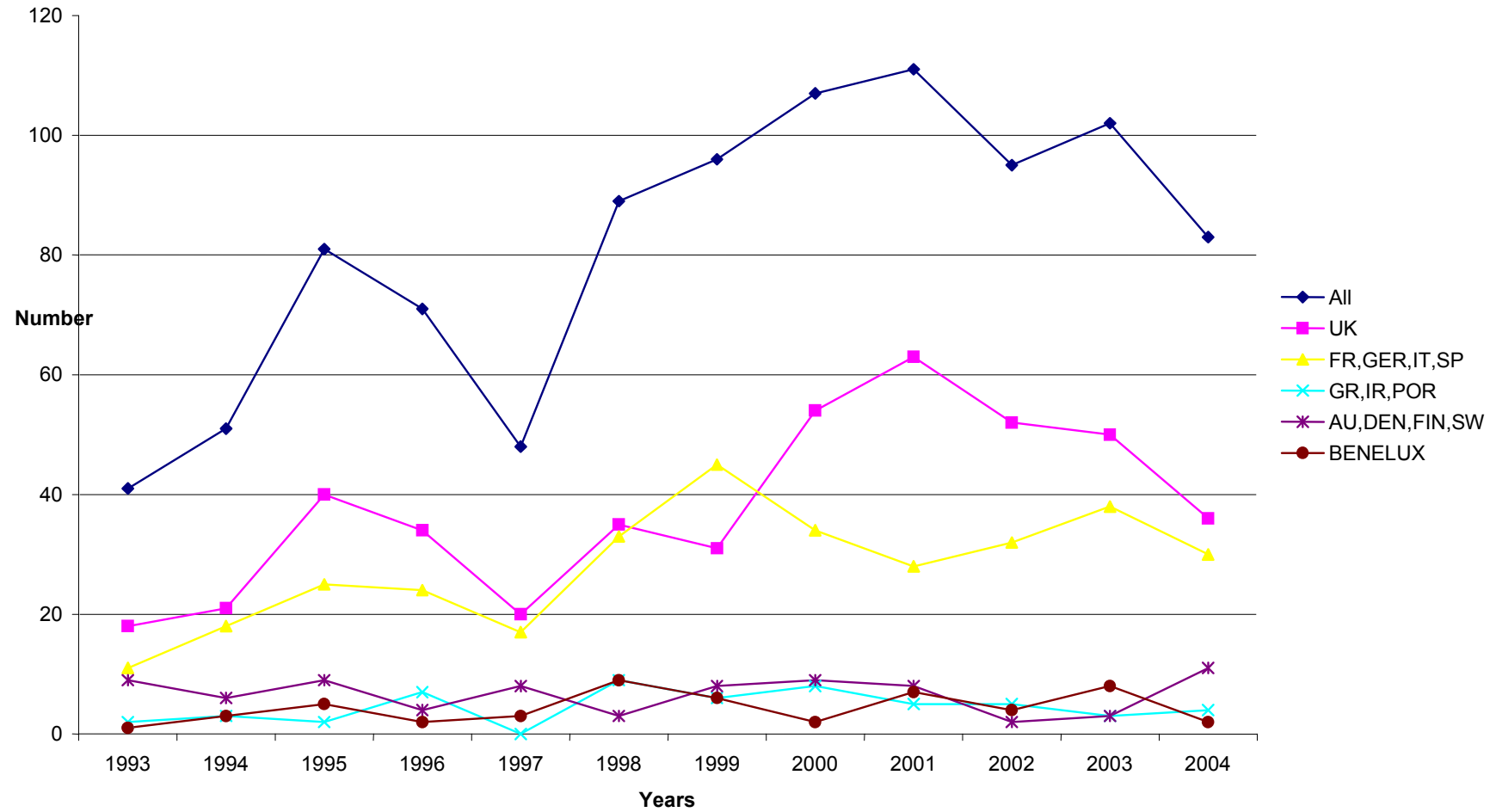


Figure 3: Value of banking M&As in EU countries, 1993-2004 (mil US\$)

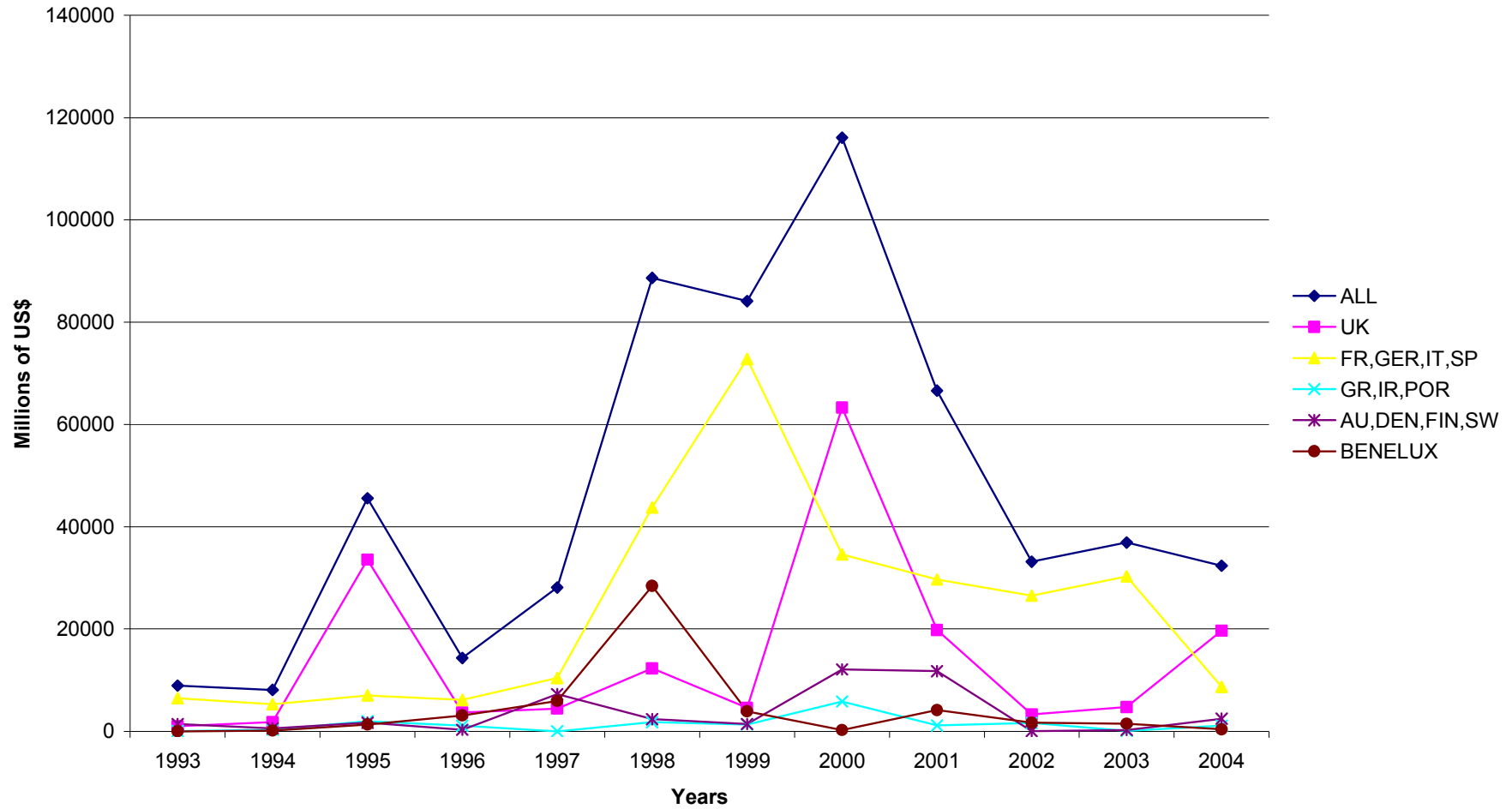


Table I: Major M&A deals (over US\$10 billion)

Year	Origin of Target Bank	Groups involved	Value of deal (billion US\$)
1995	UK	TSB Group and Lloyds Bank	15.32
1998	Belgium	Fortis AG and Generale de Banque SA	12.30
1999	France	Banque Nationale de Paris and Paribas	13.20
1999	Italy	Banca Intesa SpA and Banca Commerciale Italiana SpA	12.80
1999	Spain	Banco de Santander and Banco Central Hispanoamericano	11.32
2000	UK	National Westminster Bank and Royal Bank of Scotland	38.53
2004	UK	Banco Santander Central Hispano and Abbey National plc	15.79

Figure 4: Deal value of M&As as a % of the total market value of the EU banking sector

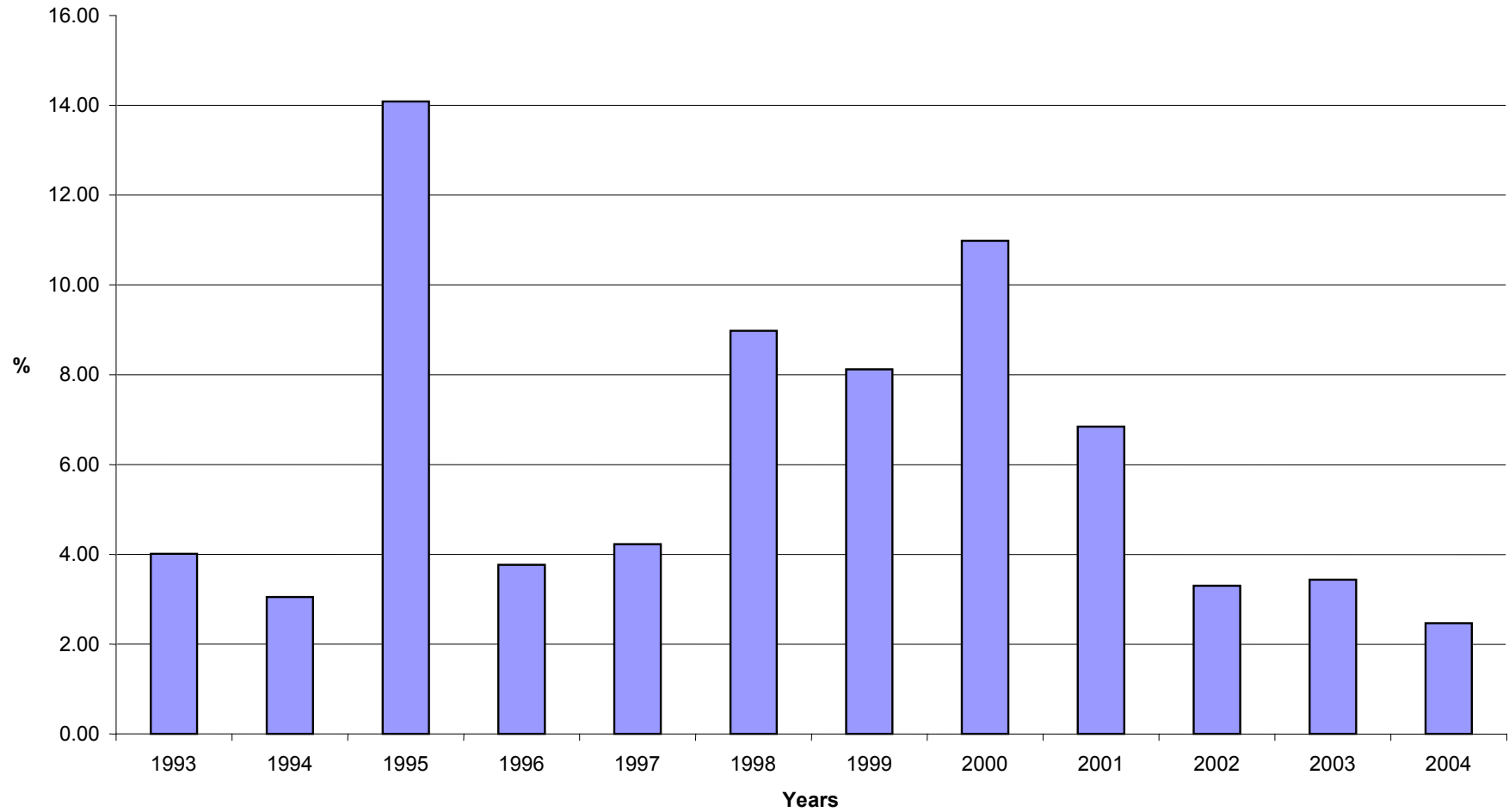


Figure 5: The profile of banking M&A activity in the EU, 1993-2004 (based on value)

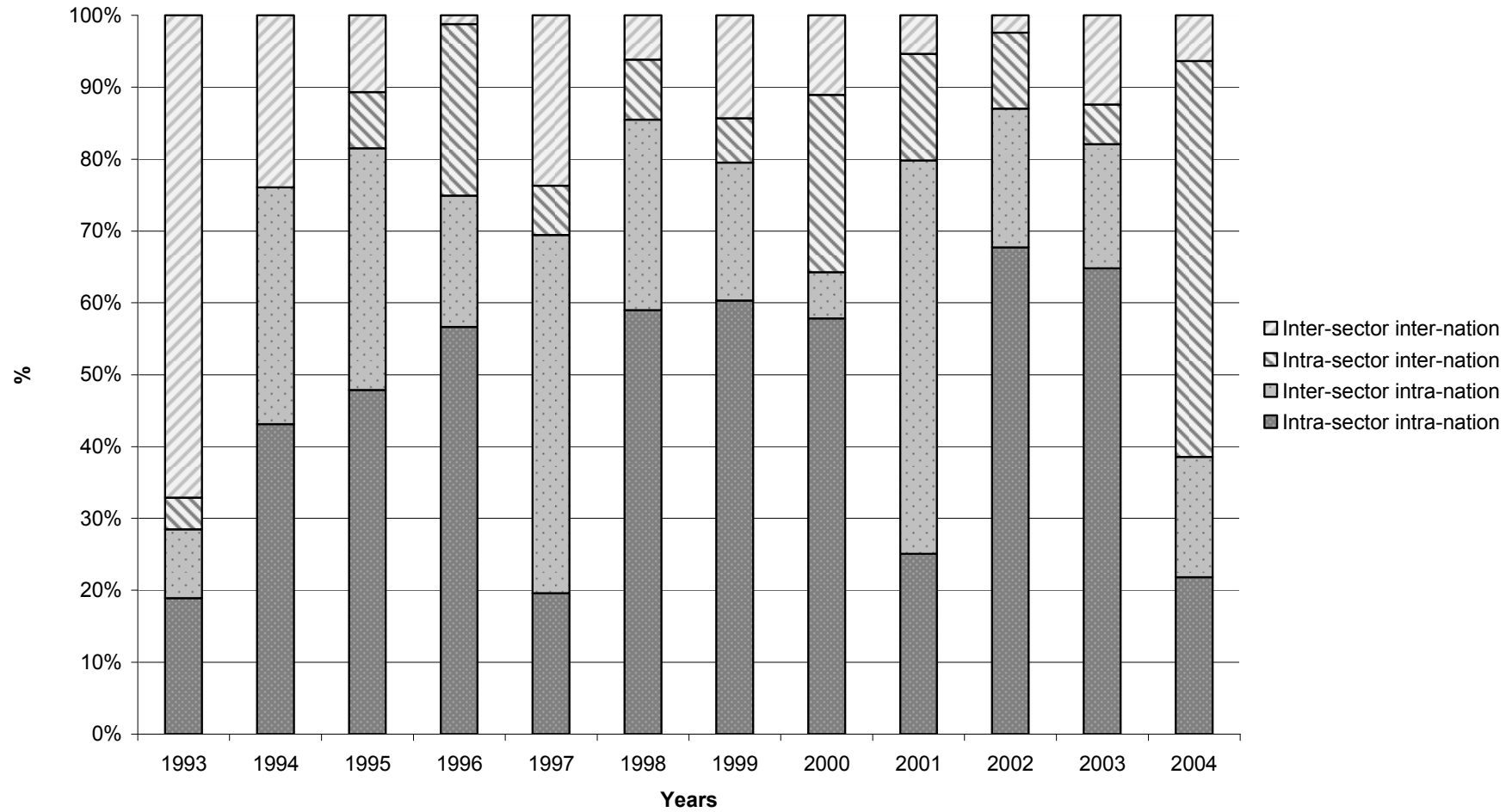


Table II: Within-country *versus* cross-border M&As, 1993-2004

(percentages, based on *value* and *number* of M&As)

<i>Years</i>	<i>value of deals</i>		<i>number of deals</i>	
	<i>Within-country</i>	<i>Cross-border</i>	<i>Within-country</i>	<i>Cross-border</i>
1993	28.50	71.50	78.05	21.95
1994	76.06	23.94	88.24	11.76
1995	81.49	18.51	70.37	29.63
1996	74.93	25.07	84.51	15.49
1997	69.44	30.56	64.58	35.42
1998	85.51	14.49	61.80	38.20
1999	79.51	20.49	71.88	28.13
2000	64.26	35.74	59.81	40.19
2001	79.83	20.17	69.37	30.63
2002	87.01	12.99	82.11	17.89
2003	82.11	17.89	79.41	20.59
2004	38.60	61.40	72.29	27.71

Table III: M&As by type of bank, 1993-2004 (percentages, based on *value* of M&As)

<i>Banks Years</i>	<i>Comm with comm</i>	<i>Inv with inv</i>	<i>SMR with SMR</i>	<i>Total intra- sector</i>	<i>Comm with SMR</i>	<i>Comm with inv</i>	<i>Comm with other</i>	<i>Inv with other</i>	<i>SMR with inv</i>	<i>SMR with other</i>	<i>Total inter- sector</i>
1993	0.200	0.013	0.020	0.233	0.014	0.001	0.669	0.054	0.000	0.029	0.767
1994	0.418	0.011	0.002	0.431	0.194	0.016	0.289	0.009	0.000	0.060	0.569
1995	0.527	0.023	0.006	0.557	0.111	0.237	0.074	0.012	0.006	0.003	0.443
1996	0.533	0.217	0.055	0.805	0.014	0.045	0.122	0.005	0.002	0.008	0.195
1997	0.239	0.009	0.017	0.265	0.122	0.007	0.510	0.025	0.072	0.000	0.735
1998	0.599	0.067	0.007	0.673	0.059	0.022	0.192	0.034	0.010	0.009	0.327
1999	0.655	0.010	0.000	0.665	0.040	0.104	0.174	0.003	0.000	0.013	0.335
2000	0.779	0.033	0.013	0.826	0.007	0.072	0.031	0.022	0.004	0.039	0.174
2001	0.377	0.013	0.009	0.400	0.243	0.029	0.292	0.019	0.003	0.015	0.600
2002	0.680	0.088	0.014	0.783	0.054	0.038	0.088	0.029	0.001	0.007	0.217
2003	0.650	0.045	0.008	0.703	0.017	0.119	0.007	0.042	0.024	0.088	0.297
2004	0.737	0.028	0.004	0.769	0.099	0.008	0.049	0.020	0.006	0.050	0.231

*Note that **comm** = commercial bank and **inv** = investment bank. For convenience, Savings, Mortgage and Real estate banks (SMR banks) have been included in the same category.*

Table IV: M&As by type of bank, 1993-2004 (percentages, based on the *number* of M&As)

<i>Banks</i> <i>Years</i>	<i>Comm</i> <i>with</i> <i>comm</i>	<i>Inv</i> <i>with</i> <i>inv</i>	<i>SMR</i> <i>with</i> <i>SMR</i>	<i>Total</i> <i>intra-</i> <i>sector</i>	<i>Comm</i> <i>with</i> <i>SMR</i>	<i>Comm</i> <i>with</i> <i>inv</i>	<i>Comm</i> <i>with</i> <i>other</i>	<i>SMR</i> <i>with</i> <i>inv</i>	<i>SMR</i> <i>with</i> <i>other</i>	<i>Inv</i> <i>with</i> <i>other</i>	<i>Total</i> <i>inter-</i> <i>sector</i>
1993	0.317	0.073	0.098	0.488	0.098	0.024	0.171	0.000	0.049	0.171	0.512
1994	0.255	0.059	0.020	0.333	0.118	0.098	0.176	0.020	0.078	0.176	0.667
1995	0.337	0.151	0.070	0.558	0.058	0.093	0.081	0.035	0.035	0.140	0.442
1996	0.405	0.152	0.063	0.620	0.038	0.063	0.089	0.013	0.063	0.114	0.380
1997	0.304	0.089	0.054	0.446	0.036	0.143	0.232	0.036	0.000	0.107	0.554
1998	0.293	0.121	0.010	0.424	0.091	0.081	0.131	0.020	0.061	0.192	0.576
1999	0.400	0.114	0.029	0.543	0.086	0.086	0.095	0.019	0.086	0.086	0.457
2000	0.267	0.216	0.052	0.534	0.017	0.095	0.103	0.043	0.086	0.121	0.466
2001	0.224	0.224	0.024	0.472	0.096	0.080	0.040	0.040	0.088	0.184	0.528
2002	0.208	0.255	0.094	0.557	0.094	0.066	0.057	0.028	0.038	0.160	0.443
2003	0.241	0.188	0.045	0.473	0.089	0.116	0.027	0.054	0.080	0.161	0.527
2004	0.193	0.136	0.057	0.386	0.125	0.057	0.125	0.034	0.148	0.125	0.614

Note that comm = commercial bank and inv = investment bank. For convenience, Savings, Mortgage and Real estate banks (SMR banks) have been included in the same category.

¹ See, for example, annual reports of Royal Bank of Scotland Plc and HBOS Plc over the last few years.

² It should be noted that the EU expanded to encompass 25 member states on 1st May 2004. However, details relating to the new members have not been included in our analysis, since this would have produced an inconsistent data set over the time period.

³ Traditionally, Spain would not be included in such a grouping of ‘core’ EU countries. However, we have grouped it here to reflect the significant developments that have taken place in Spain over the last decade, both in terms of the banking sector and the economy in general.

⁴ The underlying motives of acquirers constitutes an important research question in the context of M&A activity. However this question is not the purpose of this paper since we are concerned with the overall pattern and scale of activity in this sector.

⁵ The takeover of Belgian bank Generale de Banque SA by Fortis AG could be seen as cross-border nature, since in 1998 Fortis AG was a Dutch-Belgian banking and insurance group (European Commission, 1998).

⁶ The sector of a bank was defined by the SIC code of its primary activity.