

MOTIVES AND DETERMINANTS OF THE PROCESSES OF MERGERS AND ACQUISITIONS OF BANKS IN THE USA, EU, AND TRANSITIONAL ECONOMIES OF CENTRAL AND EASTERN EUROPE

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DOI: <https://doi.org/10.31410/eraz.2018.169>

Abstract: *In modern banking, the processes of mergers and acquisitions has become a strategic tool of ownership transformation of the banks with the purpose of developing and improving their performance.*

The main goal of this paper is to analyze the motives and determinants of the processes of mergers and acquisitions of banks in the US, the EU and the transition economies of Central and Eastern Europe and recorded their differences.

Key words: *Mergers and acquisitions, banks, transition economies, motives and determinants.*

1. INTRODUCTION

The process of mergers and acquisitions of banks is a very interesting and dynamic category, which in the future will be an endless source of debate, controversy and researches. In world practice, there are different views on the main motives and determinants of the processes of mergers and acquisitions of banks.

Therefore, the main aim of this paper is to analyze the motives and determinants of the processes of mergers and acquisitions of banks in three different regions: the United States, the European Union and the transitional economies of Central and Eastern Europe and recorded their differences.

Conceptually the paper is organized in an introduction, three sections, conclusion and references.

2. ANALYSIS OF THE MOTIVES OF THE PROCESSES OF MERGERS AND ACQUISITIONS OF BANKS IN THE USA

There are several main motives of the processes of mergers and acquisitions of the banking sector in the USA (1):

- ❖ One of the motives of the processes of mergers and acquisitions of banks is the effort of the managers to create business empires. According to Milbourn, too self-confident managers encouraged processes of mergers and acquisitions because they overvalue its ability to manage large banks (2). On this manner, is being created certain pressure on the other managers, which are encouraged to join in the wave of mergers and acquisitions;
- ❖ As the second motive of the processes of mergers and acquisitions of banks is considered the increase of market power. Berger offers a very detailed test of two

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competing hypotheses on the territory of the United States: 1. Hypothesis: performance – structure - behaviour, which suggests that large banks use the large market share in order to achieve higher prices and higher revenues and 2. Efficiency hypothesis: which posits that the banks grow because they are more efficient and not use their market power to gain higher revenues (3). However, although he revealed that operational efficiency might partially explain the higher earnings, he believes that profitability may not be well explained by the concentration nor the traditional measures of efficiency. Another way of understanding the significance of the motive of the market power is to investigate whether the processes of mergers and acquisitions that occurred due to deregulation, caused an increase in efficiency. Namely, Stiroh and Strahan, shown that in the United States, the process of deregulation, increased the probability of efficient banks through the process of mergers and acquisitions to increase its market share and thus increase the efficiency of banking in general (4).

- ❖ As a third, very important incentive for the processes of mergers and acquisitions in the banking sector of the United States is considered the possibility of diversification, which can refer to a geographic diversification (spread of certain regions or countries), business diversification (diversification of different types of clients) and product diversification (introduction of various products/services). Demsetz and Strahan, presented strong evidence that large bank holdings in the US are better diversified than small (5). Berger considered that the benefits of the processes of mergers and acquisitions are not derived from improving the cost efficiency, but rather on improved revenue efficiency and improvements in revenue performance is due to better diversification (6).

2. ANALYSIS OF THE MOTIVES OF THE PROCESSES OF MERGERS AND ACQUISITIONS OF BANKS IN THE EUROPEAN UNION

Driving motives for the implementation of the processes of mergers and acquisitions in the banking sector of the EU we can classify into three categories. The first motive, which is basically, the simplest and most traditional, is the desire to reach an appropriate economy of scope and improve operational efficiency, primarily through the national mergers and acquisitions. The second category concerns the motives of creating "national champions" that are a kind of defence acquisition by cross-border banking groups. The third group of motives, however, are associated with the need to create domestic secondary markets, which would allow the creation of conditions for the growth of banks and increase their profitability (7).

The most active banking sector in the EU, in terms of national transactions of mergers and acquisitions, was the Italian banking sector. In this sector, the activities of mergers and acquisitions were aimed at creating "national champions". Most notable was the merger of Sanpaolo IMI and Banca Intesa in a transaction valued at € 29.6bn. The strategic rationale for the merger was to create a dominant player within the Italian market that would also be instantly significant on the European stage. This transaction of merger reflects the two-sided desire to achieve critical mass, which is a response to the growing openness of the Italian market for foreign acquisitions companies. Transactions of national character had a major contribution to the realization of significant cost savings (8).

The period from the mid 1990s to the early 2000s, was characterized by intense processes of national mergers and acquisitions in the European banking sector. This situation contributed to a significant increase in the concentration of these markets, and as a consequence, there is an increase in the volume and number of cross-border transactions. Starting from 2000 until the emergence of the global financial crisis of 2007, the process of cross - border mergers and acquisitions reached a peak.

By the beginning of the global economic crisis, looking for new growth opportunities and better strategic positioning, European banks, with a special emphasis on French banks, attempted to realize "secondary domestic markets". The three biggest French banks, BNP Paribas, Societe Generale and Credit Agricole, conducted a very significant cross-border transactions of mergers and acquisitions. BNPP, for example, acquired Banca Nazionale del Lavoro, the Italian bank, for € 9bn. This was Europe's largest cross-border deal of the year, and saw BNPP decisively outbid BBVA of Spain. The major strategic rationale for the transaction was growth, based on leveraging BNPP's existing Italian asset management, consumer finance and investment banking activities across BNL's customer network and the generally positive reception given to the deal by the stock market suggests that investors were supportive of the growth story.

The attractions of foreign expansion seemed to be particularly compelling for Crédit Agricole. The French bank was a bidder in six cross-border deals with a total value of over €10bn; four in Italy, one in Greece and one in Ukraine. The development of Italy as a second home market is consistent with Crédit Agricole's previously announced goal of generating 50% of its earnings from outside France by 2008. The larger Italian deals also offered distribution power to complement the group's existing consumer finance and investment banking operations in Italy (9).

Even the 16 largest European banks been exercising 50% of its revenue outside the national boundaries. And to exclude the global banks (HSBC, Deutsche Bank, and Swiss banks), this percentage drops to only 43%.

Through the formation of secondary domestic markets, banks aimed to improve its strategic position and flexibility. As reasons for the creation of secondary domestic markets are

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considered banking growth and diversification of their profits. In addition, large banks sought to achieve stable and continuous presence at European level, mainly through acquisitions of small retail banks in other western sectors. As examples, can be cited, acquisition of HVB by UniCredit Bank, then Abbey by HSBC, acquisition of Banca Antonveneta by ABN Amro and so on (10).

During this period, the creation of "European champions" was the main motive of the processes of mergers and acquisitions of major European banks. In the processes of mergers and acquisitions, as target banks were selected banks who carried out cross-border transactions. However, this situation is rapidly changing with the emergence of the global financial crisis. Then had appeared a process of reduction and stagnation of the transactions of mergers and acquisitions in the banking sector.

On the trend of reduction of cross - border transactions in post - crisis period have influenced several factors. First, in this period, strategic expansion of the banks' was not a priority, because the banks were faced with significant losses, and focused on the advancement of their balance sheets.

During this period, an important was process of the divestment of non-core (non-profit) activities of banks. One example of divestment (removal) of non-core activities was transaction of acquisitions of KBL European Private Bankers (a constituent unit of KBC), by the Hinduja Group's €1.35 billion. This is a very rare transaction in which an Indian private company takes over European bank. Other deals involving the divestment of non-core businesses included Citibank's sale of its Swedish retail business to local firm Marginalen for €640m and Libyan Arab Foreign Bank's purchase of a majority stake in British Arab Commercial Bank from HSBC for €68m (11).

Although the post-crisis period was characterized by a significant reduction in cross-border processes of mergers and acquisitions, there is, however, reason to believe that this situation is only temporary. First, the number of cross-border deals has already picked up since early 2009. In this regard, the acquisitions of Fortis by BNP Paribas and of UK banks by Santander are examples of strategic cross-border acquisitions by institutions that were in a position to profit from the opportunities that arose during the crisis. Second, the limited duration of government recapitalisation measures may offer mergers and acquisitions opportunities in Europe in the near future. Third, an European System of Central Banks – ESCB survey conducted in May 2009 revealed that, rather than revising their internationalisation strategies, banks have temporarily stopped or delayed their plans (12). High growth potential still remains by far the most important driver for expansion abroad. Given the opportunities arising from the exit from government measures and based on the survey results, cross-border M&A activity is expected to pick up quickly once the economic cycle turns.

3. ANALYSIS OF THE MOTIVES OF THE PROCESSES OF MERGERS AND ACQUISITIONS OF BANKS IN TRANSITIONAL ECONOMIES

The countries of Central and Eastern Europe – CIE*, in terms of their market structure and financial systems are fundamentally different from the developed countries. The process of

* The group of countries of Central and Eastern Europe include: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Poland, Romania, Slovakia, Slovenia, Serbia and Montenegro (OECD group).

globalization since the early nineties has rushed these economies in a long painstaking process of transformation from centrally planned to market economy.

In the process of transition, there was often the dilemma of monetary authorities whether the process of transformation of the banking system to focus on the restructuring of the existing domestic banks that were burdened with debts and irrational business or banking system to be open to foreign, efficient and aggressive banks which will quickly take position on the financial market and dominate. The experience of transitional economies showed that the two approaches were not contradictory, but rather are combined with one another.

Exactly the process of transition was a basic motive for initiating the process of mergers and acquisitions in the banking sector. The transition, widely opened the doors for foreign banks in these areas. Western European banks have preferred through the process of acquisitions to acquire ownership and control of management over existing state banks than to build new bank capacities in the form of green field investments. In addition, through the processes of mergers and acquisitions, Western banks have been able to quickly and efficiently increase their participation in the banking markets of transition economies and take advantage of existing networks of customers and distribution channels.

The processes of privatization were not conducted at the same speed and did not cover all countries. Czech Republic, Estonia, Latvia and Slovakia in 2002 had a small share of state banks in the total assets of the banking sector. Privatization programs in Romania, Bulgaria, Croatia, Czech Republic are consisted in negotiations between the governments of those states and one foreign bank. After removal of bad loans from the balance sheets of state owned banks, and Hungary opted for intensive sale of a controlling stake in large state banks to foreign investors. As a result of the privatization of existing state-owned banks in 2005, part of non – performing loans, in banks' balance sheets, significantly decreased to 6.4% for certain countries of Central and Eastern Europe (Romania, Bulgaria, Croatia, Czech Republic) (13).

Starting from 1993 to 2000, the number of foreign banks in the countries in transition has increased. Namely, in 1993, the total number of foreign banks in certain countries (Czech Republic, Croatia, Estonia, Latvia, Hungary, Poland, Slovakia and Slovenia) was 21. The largest number of foreign banks, more specifically, seven foreign banks, in 1993 had the Czech Republic and Hungary. In 2000, the total number of foreign banks in the listed countries had increased to 92 banks. The largest number of foreign banks in 2000 had Hungary - 26 foreign banks and Poland - 23 foreign banks (14).

Advantages of the processes of acquisition of domestic banks by foreign banks are: offering a wide range of services by foreign banks, offering higher quality financial services, implementing effective risk management in banking operations, introduction of new banking technology and innovation, development of financial markets, improving the infrastructure of the financial system, and strengthening of competition in the banking sector.

As regards of economy of scale, unfortunately, should be noted that for transitional countries there are no comprehensive analysis of the topic - economies of scale. In order to see if there is economy of scale in the banking systems of transition economies, the simplest way is to compare the indicators of the balance sheet relating to the costs of the various forms of assets. The results of the sample of the observed transition economies are given in Table 1. The indicator cost-to-income is a kind of rough measure of cost efficiency because banks offer different package of products and services.

Total assets	Ratio of costs / income			Income on average equity			Non-interest income /total income		
	<\$1 billion	\$1-10 Billion	\$10-25 billion	<\$1 billion	\$1-10 billion	\$10-25 billion	<\$1 billion	\$1-10 billion	\$10-25 billion
Eastern Europe	64,0	52,6	71,4	8,5	27,6	0,5	36,4	32,8	21,3
Czech Republic	62,3	47,6	62,0	-1,6	-7,2	-20,1	32,1	31,3	36,3
Hungary	77,2	69,3		6,0	13,8		36,9	34,2	
Poland	57,8	53,5	80,5	12,8	24,0	-7,2	36,5	35,8	27,6
Turkey	57,8	49,2	73,4	23,8	43,7	15,7	45,7	31,1	9,8

Table 1. Performance indicators by size of banks (average for the period of 1997–1999)(15).

From the data in Table 1 can be concluded that in terms of indicator of the ratio cost/revenues, in the countries of Eastern Europe, economies of scale are realized in banks with asset value of \$1 to \$10 billion. This asset value of the balance sheet, achieved the lowest indicator of ratio cost/income amounting to 52.6%, and banks are the most profitable. For the banking sector of developed countries in Europe, the indicator of cost efficiency begins to decline in banks whose balance sheet assets exceeding \$50 billion.

There are several reasons why achieving economies of scale is different in the developed European countries banking sector and in transition economies (16).

The optimal size of banks on which are realized economies of scale varies in developed and transition economies of Europe because of less efficient infrastructure (eg, telecommunications, information technology, etc.) and lower purchasing power of countries in transition. Second, in transition economies the largest share had state-owned banks that are basically less efficient than private banks. Third, in banks in transition economies due to the processes of transformation, a large volume of funds were spent on writing off bad loans and the restructuring of its activities, which automatically means increasing the cost of banks operations and less opportunity for achieving economies of scale.

CONCLUSION

Generally, there are different motives and determinants that are the driving force of the processes of mergers and acquisitions of banks in the US and EU. On the basis of empirical analysis of the efficiency of the operation of banks in the US, taking into account their post-integrative strategies, we have defined the following determinants of the processes of mergers and acquisitions: revenue efficiency, resulting from the economy of scope and the possibility of diversification, the attempt of managers to create business empires, and the increase in market power.

Driving motives for the implementation of the processes of mergers and acquisitions in the banking sector of the EU we can classify into three categories. The first motive, which is basically, the simplest and most traditional, is the desire to reach an appropriate economy of scope and improve operational efficiency, primarily through the national mergers and acquisitions. The second category concerns the motives of creating "national champions" that

are a kind of defense acquisition by cross-border banking groups. The third group of motives, however, is associated with the need to create domestic secondary markets, which would allow the creation of conditions for the growth of banks and increase their profitability.

From the analysis of the determinants and motives that encourage the processes of mergers and acquisitions of banks in the transition economies can be concluded that the banks in transition countries are faced with increased pressures on their incomes. Therefore, they need the strategy of cost reduction or improvement of cost efficiency. One of the ways to implement it are the processes of mergers or acquisitions by Western European banks. In this way, the increase in efficiency is a good incentive for the implementation of these processes. Increasing effectiveness of the banks through their consolidation in future will be an important process of bridging the differences between transition economies and the developed countries of EU.

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