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# MAJOR DRIVERS OF THE PUBLIC POLICY AND FINANCE RESPONSES FOR EU BANK MERGERS AND ACQUISITIONS. EVIDENCE FROM THE BANK MARKET CONCENTRATION[1]

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**Abstract**

In the context of the accelerated financial integration, M & A is seen as carriers of the process. Multiple types of activities related to the facilitation of cross-border M & A are provided in the "Financial Services Action Plan". Since M & A is the carrier of the process of integration of financial processes as well as the process of globalization, the "Financial Services Action Plan" refers mostly to the M & A's regulatory process and control to ensure normal market competition. Thus, the third objective of the "Financial Services Action Plan" refers to the provision of prudential rules regarding the control and supervision of banks. The factors on which the rules depend on M & A and how they apply will deserve special attention in order to achieve the normal market functioning of M & A. Of course, M & A can be directly or indirectly affected by other objectives of the "Financial Services Action Plan" that require the provision of a secure and integrated market with identical game rules.

**Keywords:** Bank concentration, M&A, Public policy

[1] review scientific paper

## 1. Mergers and Acquisitions in the EU

It should be noted that neither in the EU "Financial services action plan" nor in the Directives that have been adopted so far there are no rules favoring M & A, but all the rules relate exclusively to the operation of the financial intermediaries regardless of their size. In the context of M & A, the role of regulatory authorities is addressed exclusively to provide conditions to facilitate integration, to ensure conditions for normal competition and to minimize the risk.The facts say that after the promotion of the "EU Integrated Financial Services Market", the number of M & A has increased, even though it did not apply to cross-border mergers, but the growth was not linear.

Therefore, two questions are asked:

-Why did the financial institutions not fully utilize the opportunities offered for integration and why they were not used for more cross-border marzes?

- Have enough preconditions for the normal functioning of the competition been provided, and to reduce the risk to a minimum level?

Regarding the first question, the answer may arise from an analysis of incentive measures for the creation of both domestic and cross-border M & A. Thus, those integrations that are made between smaller banks and other financial intermediaries relate most often to the synergistic effects that can be obtained through the integration of staffing and technical capabilities as well as diversification of the services that can be offered. [2]The mergers between big banks in turn have the primary goal of boosting market share, maintaining and increasing as well as market dominance.

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[2]BHATTACHARYA, S. and AV THAKOR (1993), Contemporary banking theory , Journal of Financial Intermediation ;

They are trying to make it through a larger capital base, but also by increasing the value of the shares. In addition to the aforementioned reasons, it is also important that cross-border M & A's provide opportunities for new services such as international portfolio management.[3]

But in terms of M & A theory, it often does not coincide with the practice. For example, in over twenty studies, so far expectations of M & A and economic justification have been so far *ex - ante* as compared to those *ex - post ,* so that banks' management knows best the reasons for the masons and acquisitions.

If we see the evolution of M & A during the 1990s, then by 1998 most of the M & A were domestic, but after 1998, the number of domestic with the number of cross-border M & A began to equate. However, compared to the US, the number of M & A in the EU is bigger.[4]

The question arises as to why the number of M & A that are of a cross-border character is not greater. In the literature, three reasons are most often distinguished:

- The first reason lies in the fact that however globalized markets still can not afford globalized from distance retail banking markets because of the close relationship that a client needs to have in such cases. This requires close geographical presence, which is difficult to secure by foreign banks in many EU countries. This adds to the costs that need to be made for getting closer to customers, and also their rationalization;
-The second lies in a variety of cultural reasons, ranging from language to managerial conflict. Thus managers of both the bank that is purchased and the

[3]ARTHUR ANDERSEN (1993), European Banking and Capital Markets - Research Report, London: Economist Intelligence Unit;

[4]Adam K., T. Japelli, A. Menichini, M. Padula and M. Pagano (2002): Study to Analyze, Compare, and Apply Alternative Indicators and Monitoring Methodologies to Measure the Evolution of the Capital Market.

merging bank are always worried about their jobs and expect a reduction in their privileges after the purchase, or simply dismissal;

-Third reason is that EU countries do not show a greater mood for comprehensive integration of national markets into a single and unified EU banking market at the moment. So there are numerous tax differences, accounting differences, differences in consumer protection, differences in payment and settlement systems.[5]

The second issue stems from the manner of regulating supervision as well as the legal framework for banks and financial intermediaries. This issue "Financial Services Action Plan" is trying to resolve it through two actions:
- By amending the Directives on Capital Adequacy and

- Development of prudential rules for the supervision of financial conglomerates.

M & A risk prevention is due to the fact that small banks as such carry out more risky activities, and when they integrate into a system of a larger bank through M & A, their portfolio becomes more quality and the risk decreases. Additionally, improvement of the market as well as operational risk. The bank that appears as a buyer is expected to have a better portfolio than the one that will be purchased.Also, with the merger of banks of similar size, improvement of capital positions is obtained, according to the second version of the Basel standards.[6]

In the cases of financial conglomerates, the risk comes mainly due to activities that take place internally, ie, internal transactions, and in conjunction with

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[6]BANK FOR INTERNATIONAL SETTLEMENTS (2000), Capital Requirements and Banking Behavior: The Basel Accord, Basle Committee on Banking Supervision Working Papers.

undercover risk exposure. This is perceived most often in managerial practice in terms of capital exposure.

Regarding the provision of growth conditions for cross-border M & A, one more parameter should be taken, which is information technology. Regarding the information technologies in the banks, it should be noted that such technologies considerably reduce their costs, and also help to improve the data needed to make the right decision. In terms of cross-border M & A the costs of collecting data outside the state are always greater than those within the state. Also, the development of e-banking reduces costs related to field work, but increases the cost of checking customer data due to increased risk. Regarding the facilitation of the development and application of modern information technologies, the "Financial Services Action Plan" can help in two ways:

- Through the implementation of the activities in the plan, which envisages greater integration of the retail banking market, and

- Through the application of legal acts envisaging the deepening of the internet banking market and its complete integration within the EU.

This should develop the infrastructure necessary for a larger number of cross-border M & A.

The level of mergers and acquisitions in the last 25 years of the EU area was extremely high. So, within the 15 Member States before the 2004 enlargement, the number of credit institutions declined from 7444 to 12.256 in 2003.

**Table 1 - Types of M & A in the European Economic Area and beyond in terms of the geographical origin of the participants**

| State | Domestic | Intra-EEA | Outside the EEA |
| --- | --- | --- | --- |
| Belgium | 10 | 14 | 26 |
| Denmark | 6 | 11 | 3 |
| Germany | 91 | 29 | 51 |
| Greece | 21 | 9 | 10 |
| Spain | 47 | 36 | 42 |
| France | 80 | 31 | 39 |
| Ireland | 1 | 3 | 3 |
| Italy | 154 | 27 | 22 |
| Luxembourg | 0 | 21 | 3 |
| Netherlands | 9 | 17 | 17 |
| Austria | 18 | 4 | 27 |
| Portugal | 14 | 14 | 6 |
| Finland | 2 | 5 | 5 |
| Sweden | 5 | 12 | 13 |
| Great Britain | 22 | 11 | 33 |
| Total | 480 (47%) | 244 (25%) | 300 (29%) |

Source: ECB 2012

In the period from 1997 to 2004, of the total number of transactions related to the merger of credit institutions which amounted to 1024, 47% were transactions within one state, 25% of transactions were within the EEA and the rest of 29% were third states outside the EEA . Majority the total number of transactions with a value of EUR 581, 4 billion 76, 7% were domestic acquisitions. In terms of the extent to which banks participate as buyers of credit institutions, as many as 92% of buyers of credit institutions are banks . Domestic M&A led to significant consolidation of the banking sector in all EU Member states. But what is even more significant many of cross-border acquisitions within the EU were undertaken within the banking sector . Among them are to be mentioned acquisitions of banks in Belgium and Germany by ING Group from the Netherlands , then the acquisitions made by Nordea Bank AB with which he acquired a management package of four Scandinavian banks, as well as the German Hypoverains bank ( HVB ) acquisitions in Austria and Central and Eastern Europe . [7] The Spanish Santander Central Hispano which bought Britain's Abbey National and the acquisition of the aforementioned Hypoverains bank (HVB) now Group by UniCredito Italy. While economic theory mentions 11 " sources " of economies of scale, it seems that four of them are eligible for acquisitions and mergers of banks in Europe . [8] These are the following : economies of scale based on cost reduction, X-gains from mergers, financial diversification, and increased market power. [9]

In context of the previous we can mention the following:

[7] Nordea (2004): "Pioneering the Move Towards a European Company", press release, 23 June (www.nordea.com).

[8] DERMINE J. (2000), Bank Mergers in Europe : The Public Policy Issues, Journal-of-Common-Market-Studies ; 38 (3), September 2000, p. 409 .

[9] Financial Restructuring in European Banking & Foreign Expansion -David Marques Ibanez and Phil Molyneux, Paris 2004

- In the period from 1996 to 2008, the return on assets of American banks before taxation was 1.57%, while in European banks it was 0.57%, which is 1/3 of that of US banks.[10]

-Net margins in the euro area banks are somewhere in half of those of US banks. Thus, in the euro area, these margins are 1.68%, while the margins in the United States are 3.22%. Also since 1980-'s noticeable divergence on the sidelines of the "big " banks from the US and the "big " banks from the EU with margins of banks from EU decline while those of banks from the US are increasing.[11]

- The level of income from non-credit activities is also higher in the United States, amounting to 2.65% and in the EU, although it is rapidly increasing, it is only 1.19%. [12]

- The pre-tax profit before tax was at all in the US large banks was 5.87%, unlike that of the eurozone banks, which amounted to 2.86%. But it can also be noted that the banks' profit in the euro area varies from country to country, so in Spain it is even two times higher than the profits of French banks. On the other hand, the operating expenses of the banks in the US are much higher than those of the eurozone banks.[13]

- The market capitalization of the US banks increased 14 times in the period 1990-1999, in contrast to the market capitalization of the banks in the euro area, which has increased by 5 times in the same period.

-Only one fact goes in favor of Eurozone banks : If we compare the ratio income/expenditure, then it can be said that this coefficient is 69.2% within the

[10]Barth, James R., Daniel E. Nolle and Tara N. Rice (1996): "Commercial banking structure, regulation, and performance: an international comparison ". *Working Paper* (draft), Office of the Comptroller of the Currency.

[11]Same as previous
[12]Same as previous
[13]Same as previous

big banks of the euro area, while in the USA this coefficient is 64.8%, which means that this coefficient is 4.4% more with large Eurozone banks.[14]

However, such data should be combined with the fact that today banks are becoming more and more competed by non-banking institutions that play a significant role in the collection of capital and in its lending (while not having the same obligations to the state as banks and savings houses). [15]

Another reason for the concentration is also increased disintermediation, deregulation and major technological innovations that seek to erase the traditional boundaries between financial intermediaries. These very powerful trends have opened the doors of insurance companies, internet brokers, retail chains and even large TNCs to appear as competition for banks and savings houses. Thus, online banking pushes banks to offer a larger number of banking products, and reduces operating costs. Also, banks are forced to provide a greater number of services that are complementary to the conduct of bank accounts.

The introduction of the single European currency - the euro only reinforces the tendencies of intermediation. As a consequence of the euro, the market became much closer to the companies and became much simpler for banking operations. This was particularly the case for the development of wholesale banking, while retail banking remained a large part of the barriers.

For a wide range of reasons, economic development requires the consolidation of the banking sector :

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[14]BERGER, AN, WC HUNTER and TIMME, SG ( 1993 ), The efficiency of financial institutions: a review and preview of past, present and future, Journal of Banking and Finance;

[15]BIKKER, JA (1999), Efficiency in European banking industry: an exploratory analysis to rank countries, DNB working papers.

- Customers of banks changed over time and changed through various M & A so they appeared on the market as clients with greater bargaining power and as clients with higher capital needs, which often due to the level of their work can themselves provide it if the banks are unable to do the same.

- As long as the costs of managing large conglomerates within the EU do not exceed the benefits from the economy of the volume that took place within the EU, a clear trend is M & A that requires adequate response and consolidation of the banks. This in turn requires their consolidation and also maximizing the benefits of technology in order to achieve a significant level of protection.

- In this context, the margins would continue to decline due to intensified competition, which should be compensated by an increased level of work, given the economies of scale.

Such general qualifications should be classified. A large degree of market integration was achieved before the euro was introduced. It has long been known as a pan-European market. When it comes to this pan-European market then it creates a synergy in terms of investment banking, asset management, bank account management, credit cards and retail banking. However, in order to achieve such synergetic effects, there must be previous experience in the aforementioned segments of the banter, which, if not, can lead to losses and exit from that segment. This is well known to the bankers.

Specific partnerships are always seen as a good alternative to M &A.They have always contributed to the resolution of certain shortcomings, without being burdened by the traumatic sides of the masons. But this is not the ideal form of co-operation, because in conditions of rapidly changing environments, too many connections with partners contribute to new obligations that can often give rise to conflicts of interest. Otherwise, one of the examples of co-operation in a particular area is the partnership between the bank Dresdner Bank and the insurance company Allianz , both from Germany.

## Conclusion

Increase of the financial results , financial disintermediation and emerging alternatives for replacement of classic banking services, new needs for partnerships, introduction of the single currency and even economic development boost are the main drivers for the EU Bank M&A's. Mainly from the experience so far it can be concluded that when it came to M & A the banks applied a two-stage strategy, such as :A) in the domestic markets where they felt secure, the banks tried to strengthen their position and market share, but firstly to maintain their market position and they did it through mercury with their competitors and B) the pan-European market tried to penetrate through acquisitions of banks in other countries that were smaller than the buyer.Mergers between domestic banks were mainly dominant.Circulation of M&A to take place and out first had to be carried out at home, where the first contracts were made in order to secure and preserve the domestic market from foreign competitors, but also to provide greater power for appearance on foreign markets. In the future there will be obvious need EU policy towards oligopolies regulation to be redesigned in order new situation of several key players within the EU banking sector not to hinder economic growth and development that is largely based on the prudent and competitive financial services. Main elements of such redesign should follow the main drivers of the bank M&A .

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