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Revisiting the merger and acquisition performance of European banks

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The study examines the value creation of Merger and Acquisition (M&A) deals in European banking from 1990 to 2004. This is performed, first, by examining the stock price reaction of banks to the announcement of M&A deals and, second, by analysing the determinants of this reaction. The findings provide evidence of value creation in European banks as the shareholders of the targets have benefited from positive and (statistically) significant abnormal returns while those of the acquirers earn small negative but non-significant abnormal returns. In the case of the shareholders of the acquirers, domestic M&As and especially those between banks with shares listed on the stock market, seem to be more beneficial compared to cross-border ones or those when the target is unlisted. Shareholders of the targets earn in all cases positive abnormal returns. Finally, although the link between abnormal returns and fundamental characteristics of the banks is rather weak, it appears that the acquisition of smaller, less efficient banks generating more diversified income is more value creating, while acquisition of less efficient, liquid and characterised by higher credit risk banks is not a value creating option.

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1. Introduction

Over the last two decades, the European banking sector has witnessed significant structural changes that resulted in its consolidation through a large number of mergers and acquisitions (M&As) and increased cross-shareholdings.[2] The major factors contributing to these developments were technological advances, the globalisation of financial markets, enhanced supervision of credit systems, the creation of a single financial market in the European Union (EU) and the introduction of the euro. Also, in many countries, especially where smaller banks were active, the growth in M&As was attributed to banks' desire to increase in size in order to obtain gains in terms of market power and/or efficiency as competition in the single European market increased. This resulted in the dramatic drop in the number of credit institutions in the EU-15 from approximately 12,000 at the end of 1990 to just over 7000 at the end of 2004, with the majority of M&As bring domestic deals.

The importance of the banking sector for economic growth becomes evident from the number and value of banks' M&As to the total number of M&As and value of all sectors in Europe (see Fig. 1). The peak in M&A activity was recorded in 1999, while the average number of M&As in the post-1999 period remained well above the respective one in the pre-1999 period. It is also worth noting that the value of bank M&As to total European M&As value climbed to a double digit figure. During the 1990s, a limited number of cross-border bank M&As occurred in EU countries since banks in these countries started to be more intensively interested in expanding outside national borders, especially into eastern European countries, only from 1998 to 99 onwards. It also worth noting that during the 1990s, the majority (about 80%) of bank M&A deals took place in four member states, namely Germany, Italy, France and Austria and involved small and very small banks, as these were keen to achieve adequate size to allow survival. The increased number of deals between larger banks evolved from the need for strategic repositioning and conglomeration.

In any case, after the introduction of the euro banks have responded by seeking to consolidate their positions via M&As in order to achieve competitive viability.[3]

Taking into account the aforementioned developments, the significant contribution of the banking sector in the credit process and in the economy and the extended evidence from relevant studies analysing data from US banks, it is surprising that only a handful of studies have emerged to evaluate the stock market reaction to M&A announcements in the European banking sector (i.e. Altunbas & Ibanez, 2004; Beitel & Schiereck, 2001; Beitel, Schiereck, & Wahrenburg, 2004; Campa & Hernando, 2006; Cybo-Ottone & Murgia, 2000; Ismail & Davidson, 2005; Lepetit, Patry, & Rous, 2004).[4]

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[1] Tel.: +30 210 3203618.
[2] For an extended discussion on the developments of the European banking system, see European Central Bank (2000, 2004).

[3] See Valkanov and Kleimeier (2007).
[4] Another set of studies, small in number and utilising outdated data, has attempted to measure profitability and efficiency gains through balance sheet analysis (i.e. Focarelli, Panetta, & Salleo, 2002; Huizinga, Nelissen, & Vander Vennet, 2001; Molyneux, Altunbas, & Gardener, 1996; Athanasoglou & Brissimis, 2004; Vander Vennet, 1996, 2002) providing mixed results.

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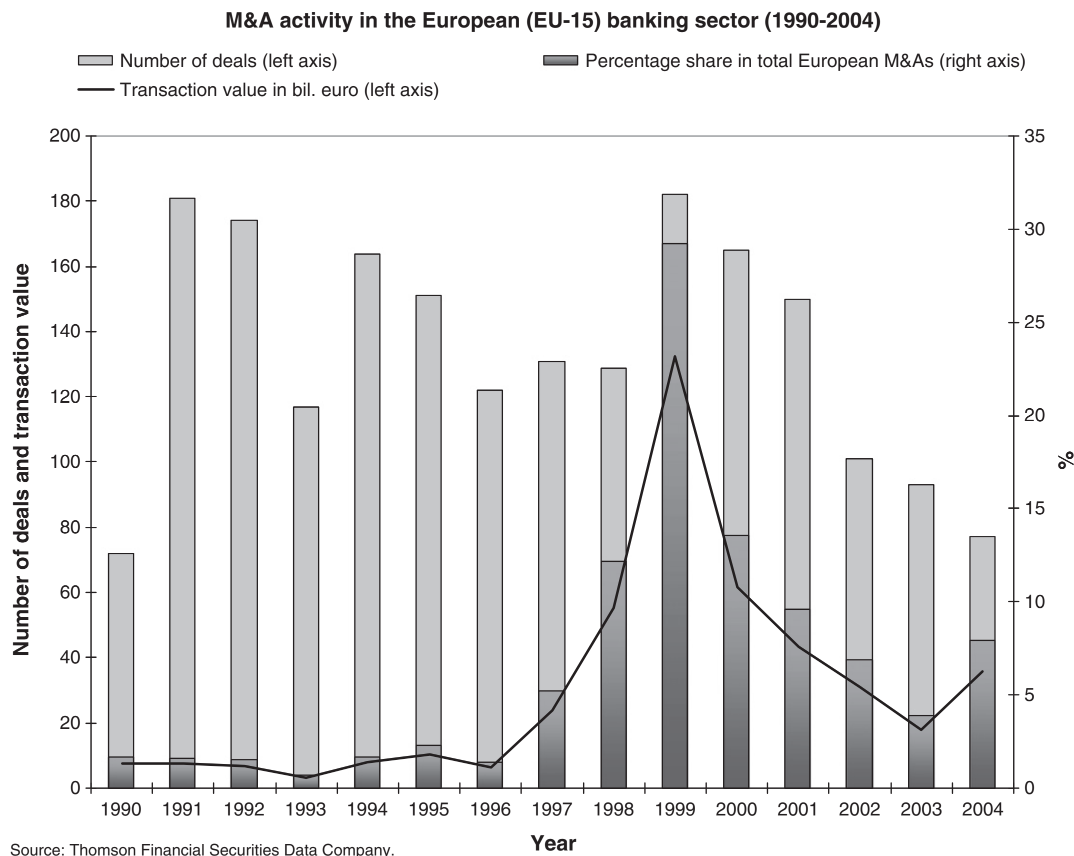

Fig. 1. M&A activity in the European (EU-15) banking sector (1990–2004).

The present study attempts to shed additional light on the value creation of M&A deals in Europe by examining the stock price reaction of banks (acquirers and targets) to the announcement of M&A deals in the period 1990–2004 using a differentiated sample and modified methodology and hypotheses compared to previous research.

First, the data employed focuses exclusively on deals between banks where the acquirer is a bank registered in an EU-15 country and the target is either a bank located in EU-15 or in an emerging eastern European country. Second, in order to analyse whether a stock market facilitates the efficient dissemination of information, the study explores the value creation of the deals not only when banks involved in an M&A deal have shares listed on a stock market, the usual approach in the literature, but also when a deal involves an unlisted bank. In this case of course only the share price reaction of the listed bank is estimated. Third, besides the typical event study methodology, abnormal returns were also estimated using a GARCH framework in order to capture the possible effects from the heteroscedastic behaviour of share prices. In addition, a series of tests were employed to estimate the statistical significance of abnormal returns. Fourth, the present paper provides further evidence on the domestic versus cross-border deals controversy. Last, but not least, we analyse the determinants of abnormal returns, an issue overlooked in previous research.

The main findings of the study are as follows: First, it provides evidence of value creation in the European banking sector as the shareholders of the targets benefited from by positive and statistically significant abnormal returns while those of the acquirers earn small negative but statistically non-significant abnormal returns. Second, in the case of the shareholders of the acquirers, domestic M&As and especially those between banks with shares listed on the stock market, seem to be more beneficial compared to cross-border ones or those when the target is an unlisted bank. Third, shareholders of the targets earn in all cases positive abnormal returns. Fourth, although the link between abnormal returns and fundamental characteristics of the banks is rather weak, it appears that the acquisition of smaller, less efficient banks generating more diversified income are more value creating, while acquisition of less efficient, liquid and characterised by higher credit risk banks is not a value creating option.

The study is structured as follows: the following section reviews the theoretical arguments behind the emergence of M&As together with the respective empirical evidence recorded on stock market reaction to M&A announcements. Section 3 deals with the sample and the methodology and Section 4 presents the empirical findings. Finally, Section 5 concludes.

2. M&As and stock price reaction: theory and literature

2.1. The rationale, advantages and risks of M&As

Several arguments surround the advantages (motives) and risks of M&A deals (i.e. see Berger, Demsetz, & Strahan, 1999) and a useful summary of these is presented in Table 1.

Economies of scale are the main argument behind M&As. This implies that banks proceed with M&As to reduce operating cost by cutting down branch networks and staff overheads and also by integrating information technology and risk management systems. On top of that, increased competition generates an incentive for banks to attain the appropriate size in order to take advantage of the market power and the larger capital base. Also, *size* may act as a defensive mechanism for banks wishing to withstand external pressures arising from larger banks that may want to expand through acquisitions. *Economies of scope* are another rationale for M&A deals involving banks. Such economies are better exploited when a bank combines its business with another financial company in order to achieve complementarities and benefits from the cross-selling of products from existing distribution networks.

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