

A M&A PROCESS PERSPECTIVE IN THE BANKING SECTOR

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Abstract

The banking sector turmoil has produced important structural changes, and generated significant opportunities for banking institutions to initiate mergers and acquisitions. Notwithstanding, many of them fail to anticipate strategic aspects that could affect the outcomes of such transactions. This is a well-established fact, but the main reasons for it are less comprehensible. M&As within the banking sector are not a completely new phenomenon but the new wave of M&As in this sector has brought a lot of attention to these deals. For example, in 2014, CIT Group Inc's acquisition of OneWest's (\$21.8 billion in assets), and BB&T Corp's acquisition of Susquehanna Bancshares Inc's (\$18.6 billion in assets). This paper contributes to the management literature by analyzing the motives behind cross-border mergers and acquisitions (M&As) for international banks in order to get an understanding of why they find it necessary to merge and/or take over other banks and the key reasons whereby banks' M&As can go wrong.

Key words: mergers and acquisitions (M&As), M&A performance, banking industry.

Introduction

Many histories of bank M&A begin in the late 18th century. However, mergers coincide historically with the existence of banks. In 1784, the Italian Monte dei Paschi and Monte Pio banks were united as the Monti Reuniti. The new banking M&As activities have attracted a lot of attention to the banking sector. The interest comes from researchers and practitioners trying to explain the main reasons behind cross-border M&As and their

outcomes. M&As within the banking sector are, however, not a completely new phenomenon, these activities took place years ago as a result of changes to a large extent in economies structures.

Bank M&As come in waves and are changing the structure of the banking sector. These waves of bank M&As are responses to the driving forces for change such as information technology and the integration of international capital market, where particularly relevant is the creation of the single currency in Europe. M&As are changing the structure of the banking industry but are not easy to accomplish successfully. M&As within the banking industry are currently widely discussed by practitioners and academics due to the fact that the context, scope and purpose of M&As seem to have changed in recent years.

Some previous studies in bank M&As claim that the performance will be reduced rather than increased as a result of M&A as a result of several factors, for instance cultural differences and costs from necessary adjustments. Notwithstanding, many banks choose to take over banks in different national cultures, or merge with banks with different organizational cultures. For instance the world's biggest bank takeover to date was a failure: in 2007, a consortium of the Royal Bank of Scotland Group (Scotland), Fortis (Belgium) and Banco Santander (Spain), known as RFS Holdings B.V. acquired the ABN AMRO Bank NV (Netherlands). Consequently, the bank was divided into three parts, each owned by one of the members of the consortium in order to avoid the critical integration processes. In spite of this, the result was the decline and fall of ABN Amro.

Scholars and practitioners also look into whether or not banks reach their objected motives after an M&A, taking into account timing; past experience; organizational culture and integration strategy. They have long recognised that the strategic fit among merging banks is a critical factor in determining the success or failure of a deal. Strategic similarities between merging banks improve performance, thus providing general support to the view that mergers between strategically similar banks are likely to provide greater benefits than mergers involving organisations with different strategic orientations.

1. The determinants behind cross-border M&As

In response to the globalization of financial markets, the banking industry strategic positioning and strategy implementation changed. The management concluded that opportunities for domestic consolidation have been exhausted in many markets and there is a tremendous pressure to increase profits. With regard to the motives behind cross-border M&As, there is

a need to differentiate according to the type of M&A, the size of the banks involved and the target region of the world. Small and medium bank M&As are mostly being carried out for economies of scale and to achieve a size that allows survival in the financial market. Large bank M&As often have an element of strategic re-positioning and are intended in order to diversify the risks and to smooth income volatility.

M&A necessarily involves organizational change, integrating some or all parts of the original organizations' functions and activities (Seo, Hill 2005). The degree of organizational change can vary substantially across M&As because the motives and types of M&As differ widely. Other authors, e.g. Hofstede et al. 2010 point to "cross-border learning" in M&A. They show that lack of universal solutions to management and organization problems does not mean that countries cannot learn from each other. On the contrary, looking across the border is one of the most effective ways of getting new ideas for management, organization, or politics. But their export calls for prudence and judgment. Nationality constrains rationality. Overall, the need to be big enough in the market and the pursuit of increased profitability prevail as motives. The new bank resulting after a M&A will have a larger customer base in a larger market, will allow the transfer of knowledge and capabilities, leading to cost and revenue efficiency in the new entity created.

Zait et al. (2014) define an integrated system of determinants of FDI (especially on M&A) composed of seven categories of determinants: Economic, Social, Cultural, Institutional, Technological, Organizational and Commercial. In turn, Marks and Mirvis (2011) highlight that buying a company encompasses strategizing, scouting, assessing and selecting a partner, deal making, and preparing for the eventual combination. The typical approach involves a "tunnel vision" on the financial aspects of the deal. Buyers concentrate on what a target is worth, what price premium, if any, to pay, and how to structure the transaction. The successful approach, by comparison, also emphasizes finance but adds careful attention to how a combination advances the business strategy of a firm, due diligence on behavioral and culture factors that might complicate the combination, and a clear picture of how the firms will be integrated.

Other authors such as Dutordoir et al. 2014 claim that in only 8% of the observations the estimates of the synergy include forecasts of revenue enhancements as a result of the merger. In these few observations, revenue enhancements amount to 39% of the total disclosed synergy value.

M&A is a multilevel, multidisciplinary, and multistage process which requires a pluralist approach, as Warter and Warter (2014) argue. M&A researchers have focused generically separately on pre-acquisition factors and post-acquisition influential factors. Neither scholars nor practitioners have

a comprehensive understanding of the factors involved in the M&A process and their interrelationships. In some countries with high concentration in the banking industry, cross-border M&As may be driven by concerns among bankers that further national consolidation of large organizations would cause opposition from local anti-trust authorities. On the other hand, cross-border M&As may be hampered by political resistance and/or tax and accounting specificities in target countries.

Kling et al. (2014) point out that, compared with a home-region-oriented firm, a global firm is more likely to possess the experience and managerial skills required to effectively integrate acquired foreign businesses. An interesting opinion (Proft 2014) shows that mergers conducted within a merger wave show less quality and more uncertainty as compared to mergers realized outside a wave. Xing et al. (2014) consider that at the level of the individual, the influences of national culture and economic ideology combine to produce a value system that is fully aligned with neither culture nor ideology. Also, in today's M&A environment, the fact that many organizations are in desperate need of capital infusions translates into strategic opportunities. Some potential acquirers have strong cash positions and this could lead to successful deals with less competition.

Royer (2013) asserts that organizational aspects need to be included appropriately into the decision-making process, as well as the expertise and topical understanding of the relevant stakeholders. According to Konstantopoulos et al. (2009) the factor of "stakeholder briefing" during merger negotiations plays a significant role for the course of the whole process of negotiation. The same authors remark that an important factor for the successful outcome of a merger is also the methodology of briefing enacted by the leaders of the banking branch during both the negotiation and merger process. Synergy expectations are positively related to announcement period returns, longer-term performance, and the market's reaction to quarterly earnings announcements (Cicon et al. 2014).

In summary, mergers and acquisition studies suggest that the realization of operative synergies requires similar organizational contexts (especially similar management systems) in addition to resource relatedness (Knoll 2008). Furthermore, they imply that the realization of operative synergies calls for organizational integration that facilitates coordination.

2. Performance as a path to success or failure

One of the enduring paradoxes in M&A activity has been the propensity of corporations and executives to engage in M&As despite consistent evidence that post-merger performance of acquiring firms is disappointing (Zhang et al. 2014). A possible explanation to this paradox is that existing

knowledge on M&As provides a limited and insufficient understanding of different parts of this important phenomenon.

The success of a M&A depends to a large extent on the banks ability to assess the relatedness of the assets of both banks and the cultural differences as well as to being able to integrate the two banks. A cross border M&A may make the integration process more difficult due to cultural barriers. Misunderstandings due to cultural differences may cause delays in the integration stage which will cause increased costs. In a recent paper, Warter and Warter (2014) conclude that even in scientific research culture, through the influence on behaviour, attitudes, and positions towards action is a major factor of facilitating, blockage, success or failure.

He (2009) highlights that the acquisition process may affect performance, as acquiring companies adopting a ‘soft approach’ or introducing ‘gradual changes’ are more likely to gain knowledge of the subsidiary progressively. As a result, they may have more time and resources to deal with the challenges and difficulties of the integration process. Furthermore, cross-border M&As also create a communication problem due to language barrier. There are, though, also positive consequences as a cultural diverse bank will have better knowledge and understanding for how the customers of different cultures will behave. This will also positively impact the managerial quality of the bank and increase efficiency.

Weber et al. (2012) affirm that with few exceptions, past literature has not considered the possibility that the management of the acquired firm and the interaction between the acquiring and target management teams after the merger can play a key role in M&A success. In turn, Gomes et al. (2014) highlight that negotiation has been under researched and will continue to play a crucial role in the success of strategic alliances at the pre and post agreement phase.

The international bank M&As raise some concerns regarding the increased difficulty in managing the bank due to its size and the distance between the offices. Furthermore, when two banks are merging the salaries of the acquired bank are generally lower, so it may be necessary to equalize them. These adjustment costs could have a negative impact on M&A performance. An important factor for the successful outcome of a merger is also the methodology of briefing enacted by the leaders and managers of the two banks during both the pre-merger and post-merger stages.

Marks and Mirvis (2011) highlight that the Merger Syndrome is a fusion of uncertainty and the likelihood of change, both favorable and unfavorable, that produces stress and ultimately affects perceptions and judgments, interpersonal relationships, and the dynamics of the combination itself. At the organizational level, the Syndrome is manifested by increased

centralization and lessened communication, leaving people in the dark about the combination and fueling rumors and insecurities. This often produces worst-case-scenario thinking that distracts employees from regular duties. All of this hampers integration, reduces productivity, and contributes to turnover of key people.

An interesting paper (Meglio 2010) remarks that findings present a fragmented state of affairs with a proliferation of operational definitions of post-acquisition performance and a wide array of indicators. Moreover, different perspectives and time lags are accounted for. This is a partial explanation for inconsistent and contradictory findings about M&A performance. This analysis can be extended and improved in several ways. A first option is to enlarge the scope and the time span of the review. Although the realm of technology-driven M&As play a prominent role in changing the landscape of several industries, M&A performance in low-tech and service industries deserves further attention. As for the time span, it should be enlarged, from 1970s to date, to account for trends over a longer period of time. The author conclusion is that findings provide evidence that a serious reflection on construct measurement is needed.

Prior studies showed that over 50% of mergers and acquisitions fail and do not increase organizational performance so the merged banks have to change management with poor performance records into new management to improve performance of the new organization and to apply culture integration to merger strategies.

Teerikangas et al. (2011) emphasise the roles that integration managers undertake in the postacquisition phase with regard to capturing acquired firm value in the acquiring firm. The findings confirm that integration managers have (a) a staff mobilizer, (b) a know-how respecter, and (c) a know-how promoter role. Mirc (2012) emphasises that synergy creation is one of the most important drivers of post-acquisition performance and relies fundamentally on organizational and individual cooperation. Another reason of poor M&A performance could be the high rate of employment turnover resulting in loss of talented employees who prevents knowledge sharing during the integration process.

Success depends on decisions in different M&A phases. To successfully manage M&As, managers need to be aware of these complex relationships – there are no simple solutions to complex problems (Bauer, Matzler 2014). Trompenaars and Asser (2010) consider that organizations that are able to reconcile their differences will have created competitive advantage. If they do not, they will end up amongst the 70% of mergers that fail. Every party should contribute, regardless of whether they are the buyer or the bought, the smaller or the larger.

2. M&A particular characteristics in the banking sector

It is difficult to assess the impact of banking M&As on the new organization because it is often difficult to unravel the direct impact of M&As from the impact of other factors, such as globalization, increasing competition, or high technology change. For example, the landmark acquisition of Countrywide by Bank of America in 2008 for USD 2.5 billion illustrates the substantive damage that can result from a M&A failure. The final cost was more than USD 40 billion USD, due to financial losses, legal costs and associated expenses.

An interesting point of view is expressed by Kim and Finkelstein (2008). They show that because deposits are the cheapest source of operating capital, banks with access to large deposit volumes enjoy significant cost advantages. When these two banks merge, the combined bank can utilize these resources more efficiently by channelling capital from the lower capital cost market to the market with greater profit opportunities. This allows the combined bank to cut operating costs, to increase revenues, and/or to achieve higher margins

Banks involved in cross-border M&As will experience differences in accounting rules, in taxation, in prudential rules and practices, seeking to take advantage of them. However, these differences are not considered strong motives for M&As.

Walter (2004) highlights that commercial banking activities have several characteristics that make them a particular focus for M&A transactions. These include (1) high cost distribution and transactions infrastructures such as branch networks and IT platforms that lend themselves to rationalization; (2) overcapacity brought on by traditions of protection and distortion of commercial banking competition, and sometimes by the presence of public-sector or mutual thrift institutions and commercial banks (such overcapacity presents an opportune target for restructuring, in the process eliminating redundant capital and human personnel); (3) slow-growing markets that rarely outpace the overall rate of economic growth and usually lag it due to encroaching financial disintermediation, exacerbating the overcapacity problem; and (4) mature products that make innovation difficult in the production of financial services, combined with sometimes dramatic innovation on the distribution side, notably Internet-based commercial banking.

Scholars and practitioners argued that organizational culture within the banking industry has focused mainly on growth, and market competition. These factors have not changed the nature of core M&A activities (target identification, pre-merger due diligence, valuation and post-merger integration), but the key managers must take into account additional factors during both the pre- and post-merger stages.

According to Rosenbaum and Pearl (2009), when evaluating strategic buyers, the banker looks first and foremost at strategic fit, including potential synergies. Financial capacity or “ability to pay” – which is typically dependent on size, balance sheet strength, access to financing, and risk appetite—is also closely scrutinized. Other factors play a role in assessing potential strategic bidders, such as cultural fit, M&A track record, existing management’s role going forward, relative and pro forma market position (including antitrust concerns), and effects on existing customer and supplier relationships.

Personal interests of key managers are considered very important in banking M&A and not always a negative factor. M&As in the banking sector would probably be limited, if key managers were not personally interested in the performance, size and prestige of their institution. Personal interests are presumably to increase the motivation of key managers directly involved in M&As which will enhance the likelihood of a successful M&A. Nevertheless, in cases of large M&As top managers may be tempted by their professional ambitions to pursue increases in size, purely for the sake of size, without paying due attention to the strategic and managerial consequences.

In a recent paper (Gomes et al. 2012) is mentioned that however, for mergers involving fewer banks, certain HRM themes emerge as being of particular importance to overall outcome. These are (1) the quality of HRM due diligence, (2) the existence and handling of regional cultural differences, (3) the extent and quality of communications, and (4) the use of integration advisors to facilitate the process

The conclusion reached by Fiordelisi (2009) is that the brand name continuation is more apparent than the others, the preservation of culture, leadership and decision making are crucial to achieve the M&A strategic aims: for instance, a higher degree of autonomy would be appropriate if the target bank has excellent skills (such as the workforce ability to minimize wastes and/or customer-orientation) that are important to preserve.

Conclusions

The complexity of the M&As process has generated several challenges to making M&As a success and meeting target expectations. M&As within the banking industry are currently widely discussed in the media and academia due to the fact that the context, scope and purpose of M&As seem to have changed in recent years. M&As are changing the structure of the banking sector but are not easy to accomplish successfully. Cross-border banking M&As tend not to show positive outcomes until after a couple of years and are hence considered as long term investments. Banks’ lead-

ers and strategists recognize that the strategic fit among merging banks is a critical element in determining the success or failure of a M&A.

One part of the M&As strategies might be to reduce the personnel while asking remaining staff to maintain a higher workload. Employees retained after the M&A might perceive these actions as inequitable due to more duties with non- matching compensation. The profitability of a cross-border bank M&A should occur in the long run, and be the foundation upon which the bank grows. It is, therefore, beneficial for a bank to reach out to new global markets to build new customer connections which will raise profits for the near future. In order to be profitable the banks establish themselves in different markets where they consider themselves having competitive advantage. If the bank succeeds in achieving its targets the cross-border M&A is more likely to be successful.

Any M&A activity that involves banks from different countries can create significant problems to successful integration. These difficulties, that need to be overcome, can be: prior merger/acquisition experience, the connection between preacquisition and postacquisition processes, local taxes and regulations, way of performance measure, language and local culture, etc.

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