MERGERS, ACQUISITIONS AND BANKING CONSOLIDATION IN CENTRAL AND EASTERN EUROPE

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Abstract: Acquisitions and mergers are the growth and expansion strategies that are commonly used by the companies in all over the world because of several reasons such as increasing the profit, sales and market share, entering into new markets, operating with economics of scale, coping with managerial problems and so on. This article underlines the characteristics of mergers and acquisitions (M&A), the different types of M&A, the challenges and opportunities for the banking system in Central and Eastern Europe and we analyze the implications of the recently observed sharp expansion of foreign banks in the Central and Eastern European Countries.

Keywords: banks; M&A; Central and Eastern Europe; foreign
JEL Classification: G21; G30; G34

INTRODUCTION

Financial sector, like others sectors of the economy, is active in terms of the number of completed mergers and acquisitions, and has the effect of lowering the number of banks in the European Union, the emergence of financial conglomerates and more competitiveness in banks involved on international level.

In today's globalized business world, competition has become an unavoidable concept for all companies. There are many tools that companies can use to cope with this competitive environment, to become successful, and to sustain continuity. One of those alternatives is growth. Companies can grow in two ways which are called internal and external. Internal growth is sustained by the companies' own resources and by the gains from its own operations. External growth is sustained by cooperating with other companies in several forms. One of the ways of external growth is mergers and acquisitions which are being increasingly used as world over strategies due to globalization, technological developments, and competitive business environment. There are many advantages of mergers and acquisitions for companies such as, utilizing economies of scale, maximizing profit, being competitive, sustaining synergy, appealing qualified human resources, developing research and development operations, getting into new markets, increasing asset level, and obtaining tax advantages etc. The main reason of all of those activities is to increase the overall performance of the company. So, the effects of

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mergers and acquisitions on the performance of the acquirer and acquired companies have become an attractive research topic.

The numerous studies were made on target banks in developed countries, therefore this study will analyze the impact of mergers and acquisitions involving target banks from Central and Eastern Europe, where bank consolidation process is underway. Banks in Central and South-Eastern Europe and the former group of Independent States (Belarus, Russia, Ukraine) became favorite targets of the international banking community due to increased volume of foreign investors in these countries.

1. CONCEPTUAL FRAMING OF MERGERS AND ACQUISITIONS

Sherman (2006) highlights the following three ways used by financial institutions to extend their activity and to achieve their goals, by growing their profit:

Organic growth - achieved through expansion into new geographic markets, by increasing the number of employees that are selling products, as well as developing new products or offering auxiliary products ;

Inorganic growth - achieved through merger or acquisition in order to gain access to new product lines or new consumer segments;

External growth - achieved through franchising, joint ventures or strategic alliances.

Of all these methods, bank mergers and acquisitions are the most used techniques in strategic management of the last decade. Worldwide, the number of mergers and acquisitions has increased, because of the effects they have on both the purchasing institution and the country of origin of companies involved in the process.

However, although there are different views regarding mergers and acquisitions relationship with globalization, some experts generally thought that this type of transaction is actually an effect of globalization, while others believe that, on the contrary, this is an important factor that leads to financial globalization.

Scott (2003) defines merger as a fusion of two or more companies in which the assets and liabilities of a company are absorbed by the company that buys. Although the company that buys can be a considerably different organization after the merger, it retains its original identity. The same author defines acquisition as a purchase transaction where a bank buys an asset, a division or an entire company in order to get a bigger company.

Capraru (2011) speaks about these two types of processes and underlines that the acquisition is the process involving a financial institution, usually larger, that buys another financial institution, smaller, finally forming a new entity, while merger is the process that involves two financial institutions, usually of the same size, which form a new one.

2. TYPES OF MERGERS AND ACQUISTIONS

In accordance with regulations, bank mergers and acquisitions may be manifested by:

- merger/acquisition - means actually the internal restructuring, as the manner characteristic of financial institutions to reduce activity by closing unprofitable departments;

- merger/absorption is actually the purchasing process, involving a purchase of a financial institution by another bank. Finally, following the steps needed to achieve an acquisition, the acquiring bank will have all the rights and obligations of the acquired company.

Depending on the structure of establishments, bank mergers and acquisitions can be made vertical, horizontal or conglomerate.

A vertical M&A is a process in which the company expands forward in the direction of the customer and backwards towards the source of raw material. This is achieved by either merging with the buyer or with the supplier, by using its product or intermediary material for the final production. The choice for this form of fusion is to increase production value chain, and the cost of sale or purchase.

The horizontal M&A is obtained when a company wants to expand in the same market or to grow/enter in other markets. Horizontal acquisitions and mergers occur when a bank joins another credit institution, both on the same domain. Therefore, we can talk about horizontal M&A when the process involves two commercial banks or two investment banks. The number of these types of operations has increased in recent years due to global restructuring of the banking sector in response to technological and financial market liberalization

Conglomerate M&A is the deal that involves two companies that are engaged in unrelated industries. The basic purpose of conglomerate mergers remains the utilization of financial resources and enlarged debt capacity.

3. CHALLENGES FOR BANKING IN CENTRAL AND EASTERN EUROPE

Large international cross-border banks operating in CEE are facing several challenges in the micro and macroprudential regulatory sphere. On the microprudential level, international and Western European cross-border banks operating in CEE will have to comply with the Basel III framework sooner or later, while the macroprudential supervision and regulation is increasing in Europe as shown by the foundation of the European Systemic Risk Board (ESRB) at the ECB.

Given all the regulatory changes that have taken place or are likely to, the ESRB's (2011) issuance of a recommendation to secure some consistency in the macroprudential oversight in Europe is a positive step. While calling for a strong role for national central banks in the macroprudential oversight, the recommendation also stresses that the cross-border effects of any national macroprudential regulation must be taken into account. National authorities should inform the ESRB about significant macroprudential actions they are envisaging in order to avoid an excessive and uncoordinated regionalization of macroprudential regulation and oversight.

Given all the regulatory changes taking place, there is also an evident need to secure a level playing field in international and cross-border banking. The "Vienna Initiative 2.0" (2012) has highlighted the merits of better home-host coordination and cooperation. Simply "nationalising" the local banking systems in CEE is not the right strategy to pursue, given the fact that the capital markets in several CEE countries are still comparatively underdeveloped. For this reason, the CEE banking systems require a home-host supervisory coordination that corresponds to the degree of financial integration in the region. Moreover, the goals and strategies of large banking groups in CEE and the regulators in home or host countries do not differ all too much.

4. OPPORTUNITIES FOR BANKING IN CENTRAL AND EASTERN EUROPE

Large international cross-border banks pursuing a universal bank model are likely to have the best growth opportunities in CEE going forward. Because the attractiveness of different business segments varies substantially across the CEE markets and CEE sub-regions, well-diversified international cross-border banks are likely to profit most from the more heterogeneous character of the future banking sector expansion in the region.

The biggest near-term business potential in CEE seems to be in the segment of corporate lending and mortgage lending, while unsecured household lending demand appears to be well-satisfied in most CEE markets, with the possible exception of Russia. In fact, many CEE countries are characterized by very competitive and successful corporate sectors, supported by a very high degree of FDI penetration. Moreover, a lot of CEE countries worked hard to sustain or improve their international competitiveness position in recent years. As a result, these countries have indicators of international competitiveness that are at much more favourable levels than those in many Western European economies.

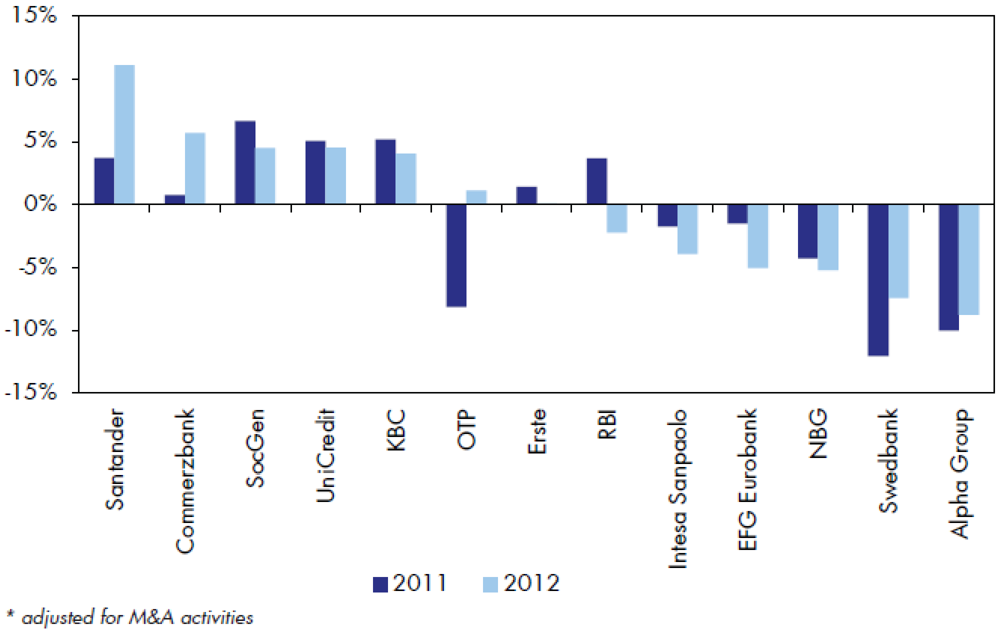
Given the current regulatory pressure on all large (Western) European cross-border banks, the top Western corporate clients in CEE might seek to diversify their bank relationships away from their "house bank" in their home market and may increasingly turn to local banks or international banks with an explicit focus on CEE.

Moreover, the demand for client-driven investment banking business in CEE is likely to increase in the years to come. Before the crisis, the capital markets environment in CEE was much more stable than it currently is. We expect the current more volatile and diverse capital markets environment that currently exists to persist. Furthermore, the relevance of local capital and currency markets in CEE is likely to continue for a much longer period than had been expected before the crisis, when most CEE countries were focused on attaining a swift entry into the Eurozone.

5. MARKET PLAYERS IN CENTRAL AND EASTERN EUROPE

The size ranking of international banks has remained almost unchanged significantly in 2012 compared to the year before. The movements are mainly driven by country specific lending trends, a.m. currency movements and – to a lesser extent – by acquisitions/divestments, which have not dominated the ranking as much as in 2010/11 due to lower M&A transaction volumes. The top five banking Groups are still UniCredit, RBI, Erste, SocGen and KBC, followed by ING, Banca Intesa, OTP. As of now, the potential tie-up between NBG and EFG Eurobank including their SEE units is getting more uncertain after being postponed given the recapitalization need of both banks. Hypothetically, a merger could create a combined unit, which might come closer to the top ten in the region.

Figure 1 - Loan book growth 2012 vs. 2011 in CEE (in EUR)

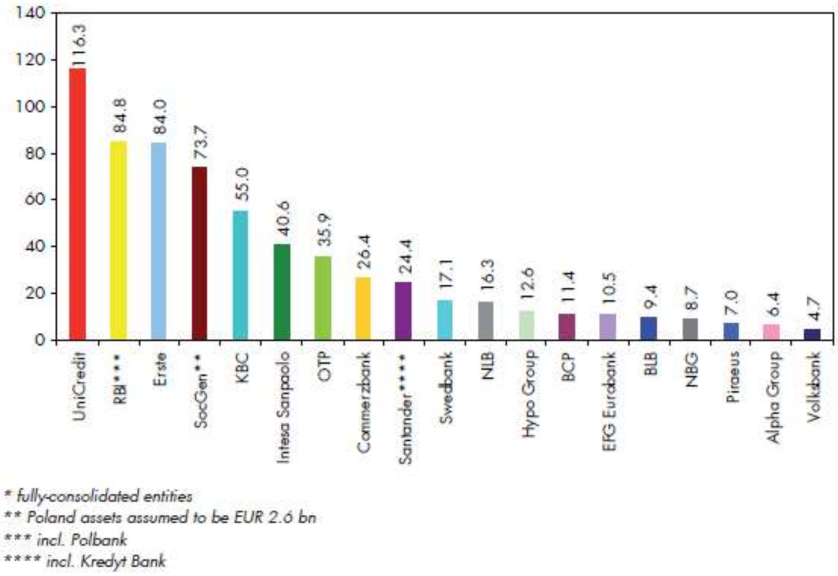


Source: CEE Banking Sector Report, available on http://www.rbinternational.com

6. M&A AND TOTAL CONSOLIDATED ASSETS

Recent M&A activity has in fact only slightly changed the ranking of foreignowned banks in CEE in terms of the total assets they have in the region. Based on 2011 figures, UniCredit still leads the regional banking sector as the biggest EU based player and has quite a significant gap (ca. EUR 30 bn) to other EU-based players. After its acquisition of Polbank, RBI has advanced to become the number two in CEE, its total consolidated assets in the region of EUR 84.8 bn outpacing those of Erste by less than EUR 1 bn. The gap of SocGen to the top three foreignowned players has diminished further, namely from around EUR 16 bn. to EUR 10 bn. KBC is still among the Top-5 foreign banks, despite the fact that its Polish assets have been sold to Santander. In 2011, Hungary's OTP and Italy's Intesa Sanpaolo also managed to defend their positions compared to 2010.

Figure 2 - Total assets of international banks in CEE (consolidated, 2011 EUR bn.)



Source: CEE Banking Sector Report, june 2012

7. OWNERSHIP STRUCTURE AND MARKET CONCENTRATION

One of the major topics in the context of high foreign ownership by Western European banks in CEE has been the commitment of these banks to the region. This commitment has proven solid in recent years. There are no signs of a retreat of dedicated Western banks from CEE markets. The aggregated CEE exposure (consolidated foreign claims) of Western European banks remained more or less flat in recent years. At the same time, Western European banks (including some relevant CEE players) were reducing other international activities substantially.

By year-end 2012, the aggregated CEE exposure of the three most important banking sectors for the region (Austria, Italy and France, representing some 50% of the total regional exposure of European banks or 45% of global crossborder CEE exposure) was more or less at the absolute level reached in 2009.

In contrast, Western European banks in general (i.e. outside of Austria, Italy and France) reduced CEE exposures by 5-6% from 2009 to 2012. These modest cuts for the whole CEE region include substantial cuts in some cases (i.e. by some 10-20%).

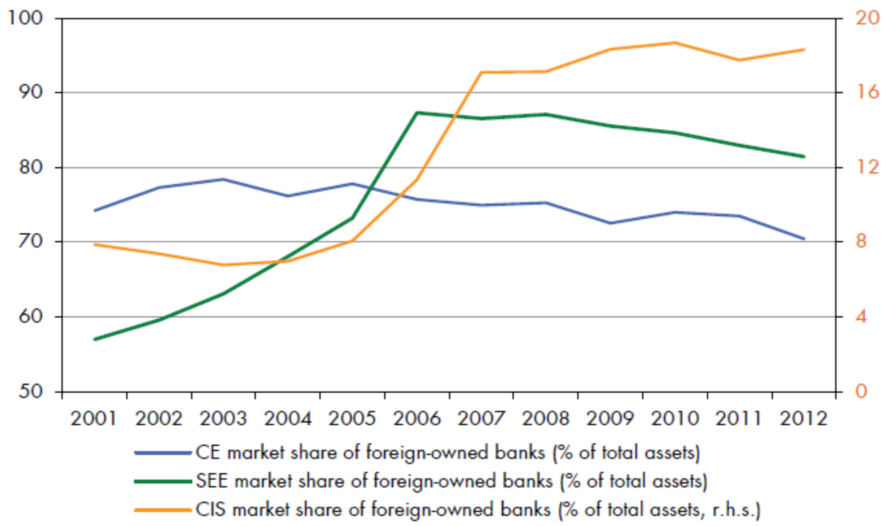
More general restructuring needs of some banks in Germany Belgium or Greece obviously had an impact on CEE. Given stronger cuts in the CEE region by other Western European banks, the relative share of Austrian, Italian and French banks in the total CEE cross-border exposure of Western European banks increased slightly in recent years (from 47.5% in

2009 to 49% in 2012). In contrast, the share of German, Belgian and Greek banks in the total CEE cross-border exposure of Western European banks decreased from 30% to around 25% in recent years. Moreover, the overall modest cuts by European banks in CEE (5-6%) still compare favorable against the massive cuts that were undertaken in the European banking sector and by Western European banks in general.

Western European banks have substantially cut their international cross-border business in Developed Markets and Western European countries in particular in recent years, i.e. by 15-20% on average with cuts of up to 40% in case of Belgian or French banks. In terms of cutting overall international/crossborder business, the banking sectors of systemic relevance for CEE by and large followed global trends (i.e. international banks from Austria, Italy and France have cut other activities outside CEE by around 15-20% from 2009 to 2012).

Given the sketched trends, the commitment of dedicated major Western European banks with a long-standing presence in CEE – despite a challenging regulatory and operating environment for Western European banks – is well reflected in international banking statistics. Moreover, these statistics also show that players with a small CEE presence (e.g. US, UK or Japanese banks that were a bit underrepresented in CEE compared to their other international activities) are seizing "niche player" business potentials in an opportunistic way. The share of the CEE exposure in total international activities of US, UK and Japanese banks increased from 7% in 2008 to around 14% in 2012, which translated into an exposure increase by some USD 50-80 bn.

Figure 3 - Presence of foreign-owned banks in the sub-regions of CEE



Source: CEE Banking Sector Report, 2013

CONCLUSIONS

Banking are now looking for new opportunities in foreign markets to replace or supplement decreased growth opportunities. Removing regulatory barriers in the European Union financial services industry will give further impetus to the strengthening cross- border activity.

The result of these operations is the emergence of larger financial companies that offer a wider range of services and operating in multiple markets simultaneously. Acquisitions and mergers in the banking sector have the capacity to ensure efficiency, profitability and synergy, also contributing to increased shareholder value. In some cases, banks with financial problems are the subject of acquisitions or mergers in the banking sector and this type of transaction may result in monopoly or downsizing. Companies all over the world use mergers and acquisitions for growth purposes in recent years.

Currently, the banking system in Central and Eastern Europe is dominated by a large number of banks that self internationally and have penetrated these markets through the acquisition of local banks.

It is therefore important to specify the preference of investors in the financial markets of Central and Eastern Europe, where there is a large number of bank branches coming from the rest of Europe, because these countries are attractive from the point of view of potential customers.

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