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A STUDY OF MERGERS AND ACQUISITIONS IN FINANCIAL SERVICES SECTOR

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ABSTRACT
This is an overview of an examination of labour market issues surrounding the question of transformation and the role of skills development in the Financial Services Sector. It formed the basis of a presentation made to the undertakings covered by Bankseta, Inseta and Fasset respectively, which was then presented in the major centres in South Africa during the month of August 2003.
Keywords: Finance, Mergers, Service Sector

INTRODUCTION

The major thrust of the task was to identify the labour market issues that would either constrain or encourage the growth and extension of skills development within the sector, and with it, the role and the contribution played by the three Setas. The term 'transformation' is somewhat imprecise in its meaning and application. It has no standardised meaning, and this adds to the difficulty of trying to encourage a process that not everybody sees as neutral, or necessary.

A term such as 'evolution' was one which I chose to use during my presentations to try to indicate that I was dealing less with issues of Black Economic Empowerment, and more with the evolution and development of the labour force, in terms of skills demanded and skills supplied. In this sense the term ‘evolution’ is more neutral. (It also implies that evolution and labour market development are necessary for survival.)

This is not to say that the issue of Black Economic Empowerment is not vitally important, it is, and especially so in the light of the imminent 'Financial Services Charter', rather similar to the policy document relating to the Mining Industry. Nevertheless, this is possibly less the immediate concern of the Setas, and a stage removed from the question of skills provision. Nevertheless, the Setas themselves may well have an important educative role. There is an important point to be made: the hyper-skewness of the size distribution of firms in the sector virtually predominates every other consideration, and accordingly demands special consideration.

The understanding of the need for Black Economic Empowerment and to a large extent the shareholding, finance and scope to accommodate it will be a function of the size of

the firm, and will prove to be a major constraint and limitation within the sector. While it will be an essential part of the major banks and life assurance companies business strategy to seek black shareholdings and to practice positive strategies of affirmative action, this cannot be said equally of the myriad of small brokerages and financial services businesses that typify the structure of the sector.

DATA AND METHODOLOGY

We use an event study approach to analyze the effects of the introduction or of changes in merger control in numerous industrial countries over the last three decades.4 In order to identify the events, we collect detailed information on the legislative changes affecting the institutional design of merger policy in the European Union (EU) and 18 individual countries: the United States and Canada, 14 EU countries, including Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Netherlands, Portugal, Spain, Sweden, and the United Kingdom, and two non-EU countries, Switzerland and Norway.5 We focus on the time period January 1, 1987 to July 1, 2004 during which most of the changes occurred. In the collection of the data, we relied on multiple sources. In a first step, we obtained and analyzed the exact text of all relevant legislation and regulation to identify the legal arrangements of the merger control in each country and the changes that took place over time. In a second step, we scrutinized the many publicly available reports on merger control to check our interpretation of the events (Appendix 1 contains a comprehensive list). Finally, we directly contacted experts of the various institutions dealing with merger control across all countries (Appendix 2 contains the list of agencies we contacted). We engaged these contacts, often in multiple and prolonged written and verbal communications, to confirm our understanding and "coding" of the data, to seek clarifications and corrections and to identify the most important aspects of merger control in practice. Our efforts resulted in a unique data set covering a wide range of information about merger control and documenting important cross-country and time-wise variation. Institutional Variables A key contribution of the paper is to aggregate the information we collected and to construct various indexes capturing the crucial dimensions of the merger

control of M&As. We construct four variables, *Criteria*, *Enforcer*, *Overturning*, and *Mandatory Notification* around the main characteristics of merger control discussed in Section II. These variables are formulated as the answers to four questions:

§ What assessment criteria are used in merger control?

§ Who is (are) the decision-making agency for merger control?

§ Can a third agency intervene in the process to replace / overturn the decision-making agency?

§ Is merger notification mandatory above (statutory) thresholds?

All variables range between 0 and 1, with higher values corresponding to a more competition-oriented design and implementation of the merger control. Our ranking of the answers reflects the simple idea that the merger review is more-competition oriented (at least from an *ex ante* perspective) when it has the single, narrower objective of preventing restrictions on competition, it is enforced by a single, independent agency, no other agency can intervene in the process, and notification is mandatory. The changes in any of the four key institutional variables across the sample period define our set of events.

EXPLAINING THE EFFECT ON BANK STOCKS

We now turn to analyzing the different investors' reaction to changes in merger control on bank stock prices. Why do banks react differently? What are the factors pushing up their stock prices? As in the other sectors, also in the banking sector the introduction or a precompetitive change in merger control should prevent excessive market power, thus reducing future monopoly profits and stock prices. Why don't we see this reflected in bank investors' reactions? To tackle these questions, we test several economic hypotheses which may explain the positive reaction in bank stock prices by regressing individual bank CARs on a number of variables capturing important institutional aspects of the merger control, the supervisory control specific to the banking sector, country institutional quality and individual bank characteristics. We discuss below our economic hypotheses and the variables we use to test them.

THE IMPACT OF BANK'S MERGERS & ACQUISITIONS ON THEIR STAFF EMPLOYMENT & EFFECTIVENESS

The beginning of an M&A process increases the odds for an individual bank to become an acquisition target. The wave of M&A is rising without there being any reasons of economic performance to justify such action. Most bank employees regard M&A as a threat to their jobs, since shareholders often demand limitations in the number of employed staff. The scope of this paper is examine is the impact of this phenomenon on employment and on the efficiency of human resources. M&A results in the Hellenic bank market have been negative in terms of employment, since 3,627 jobs have been cancelled during the 1998-2003 period. These jobs belonged to banks that were either merged or acquired. Regarding a more efficient distribution of staff in the merged banks, data confirm that the large Greek banks that chose to grow through mergers have so far been justified in their choice.

THE EMPLOYMENT IMPACT OF MERGERS AND ACQUISITIONS IN THE BANKING AND FINANCIAL SERVICES SECTOR

International Labour Office as the basis for discussions at the Tripartite Meeting on the Employment Impact of Mergers and Acquisitions in the Banking and Financial Services Sector, that held at the ILO in Geneva from 5-9 February 2001. The Governing Body of the ILO decided to convene this meeting at its 273rd Session (November 1998) as part of the programme of sectoral meetings for 2000-01.

At its 274th Session (March 1999), the Governing Body decided that the meeting should be composed of 60 participants and that the following 20 countries would be invited to participate: Argentina, Belgium, Canada, Ghana, India, Japan, Republic of Korea, Luxembourg, Mauritania, Mauritius, Nigeria, Panama, Russian Federation, Slovakia, Spain, Switzerland, Thailand, United Arab Emirates, United States and Venezuela. A number of countries were included in a reserve list from which further invitees would be drawn in the event that a government in the first list declined the invitation: Chile, China, Costa Rica, Dominica, Dominican Republic, Ecuador, Finland, France, Germany,

Honduras, Jordan, Lebanon, Malaysia, Morocco, Portugal, Singapore and Tunisia. Furthermore, it was agreed that 20 employers' and 20 workers' representatives would be selected on the basis of consultation with the respective groups of the Governing Body.

The Governing Body decided that the purpose of the Meeting would be to exchange views on the impact on employment of mergers and acquisitions in the banking and financial services sector, using a report prepared by the Office as the basis for its discussions; to adopt conclusions that include proposals for action by governments, by employers' and workers' organizations at the national level and by the ILO; and to adopt a report on its discussion. The Meeting may also adopt resolutions.

This Meeting is part of the ILO's Sectoral Activities Programme, the aim of which is to assist governments and employers' and workers' organizations to develop their capacities to deal equitably and effectively with the social and labour problems of particular economic sectors. The Programme also alerts the ILO to specific sectoral social and labour issues – primarily through tripartite meetings, which bring together a cross-section of government, employers' and workers' representatives from countries that are prominent in a given sector. In line with the reorientation of the ILO around strategic objectives since 1999, these meetings also set out to strengthen tripartism and promote social dialogue at the international level.

THE IMPACT OF CULTURE ON MERGERS & ACQUISITIONS

According to a KPMG study, "83% of all mergers and acquisitions (M&As) failed to produce any benefit for the shareholders and over half actually destroyed value". Interviews of over 100 senior executives involved in these 700 deals over a two-year period revealed that the overwhelming cause for failure "is the people and the cultural differences". Difficulties encountered in M&As are amplified in cross-cultural situations, when the companies involved are from two or more different countries.

SEVEN PITFALLS ON THE PATH TO MERGER SUCCESS

Merger success is possible; however, being part of the 17% that succeeds, rather than the 83% that does not deliver, requires more than insight. Merger success is based on acceleration; concentration and creating a critical mass for operational change (adaptation).

Up to the point in the transaction where the papers are signed, the merger and acquisition business is predominantly financial - valuing the assets, determining the price and due diligence. Before the ink is dry, however, this financially-driven deal becomes a human transaction filled with emotion, trauma, and survival behavior - the non-linear, often irrational world of human beings in the midst of change.

The seven pitfalls represent the critical and vulnerable areas of the M&A transaction. These areas must not only be valued for their negative impact on the critical success factors that drove the "deal", they are the very agenda for the organization's action in the critical first 90 days of the new entity.

In the case of international mergers and acquisitions, the complexity of these processes is often compounded by the difference in national cultures. People living and working in different countries react to the same situations or events in very different manners.

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