Stockholder gains from focusing versus diversifying European bank mergers

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EXECUTIVE SUMMARY

Several studies have underlined the tendency of mergers and acquisitions (M&As) to take place in waves. The last one to occur in Europe was in the 1990s, in particular between 1998 and 2000. The sample contains 166 mergers announcements published by Bloomberg, occurring between 2000 and 2009, involving 27 countries from Western Europe and 8 different currencies. Initially, the sample was meant to contain only mergers between companies, where at least one was a banking firm. Then it was enlarged to the whole financial industry. The focus of this study is to try to determine whether the announcement of a financial institution merger creates shareholder value in the form of cumulative abnormal returns (CARs). The mergers presented in the sample were divided into four groups according to activity and geographic similarity or dissimilarity, depending on the Bloomberg categorization. Using the market model, the abnormal returns resulting from the merger announcement were calculated. It emerged that the market slightly distinguishes between various groups of mergers. A uncertainty arose on which index would be more appropriate to use as the market return in the model. It was therefore decided that three different analysis would be run. For the first the relative national indexes for the market return of each of the merging firms were used, while the combined portfolio relied on the MSCI Europe Index. In the second analysis the MSCI Europe Index was set as the benchmark for all three market returns. Similarly to the first analysis, the relative national index was used for the target and bidding firms, but a weighted average of their relative national indexes was implemented to compute the portfolio market return. All three cases showed that mergers that diversify geographically and focus their activity create stockholder value, even though only 0.6-0.7%. The other groups presented negative CARs in all three analysis, but not significantly lower than zero.

These results are in contrast to those expected. Based on the study led by DeLong (2001) on banking firms in the United States in the 1990s, the companies that focus both their activity and geography are those that create value. A group with the same characteristics is also present in this sample and even though it contains the largest number of mergers it seems that this strategy no longer creates significant value.

Although it was not the original focus of this study an inverse relationship between the average size and CAR of the target firms was also observed. In fact, comparing the findings with the existing literature, the target firms analyzed in this study present much higher average target/bidder ratios than those in previous studies. Furthermore, the CARs of the target companies are below the average found in the literature.

Nevertheless it became apparent that bigger firms prefer to diversify both activity and geography while the smaller ones choose the opposite strategy. Furthermore the former presented the lowest average target/bidder ratio while the latter showed the highest. Apparently the higher the target/bidder ratio, the lower the CAR.

Focus and diversification are not, of course, the only factors that could influence the returns of the merger participants. These results must, therefore, be interpreted with caution.