



# Retail Banking Mergers and Acquisitions: Strategic Choices

Bank mergers and acquisitions (M&As) come in waves, and today they are once again at the top of many corporate strategic agendas. This Capgemini point of view examines the changing landscape of today's retail banking environment and considers various M&A options. Our goal is to provide a context for the strategic choices our clients now face, describe some of the pitfalls to avoid, and highlight the paths we have found—through experience—that lead to M&A success.

## A changing landscape

Dramatic changes in the global financial services market have occurred since the 1990s. Asian institutions were the giants in 1990, due largely to the inflated value of assets held by Japanese banks, and the US and Europe could claim only a single player each among the largest twenty banking institutions. By 2000, however, regional dominance on the basis of size had shifted dramatically from east to west, and the scale of institutions had increased dramatically—the largest bank's capitalization had tripled. Since then membership in the top twenty has remained relatively steady, although market capitalization rankings regularly change. The big three—Citigroup, HSBC, and Bank of America—now appear to be pulling away from the pack.

These developments are not lost on bank CEOs, who must keep a watchful eye on competitors' strategies and assess what these moves mean to their own bank's position. With their massive increases in market capitalization, the three leading banks are in a strong position to invest heavily in new products or services and to make even larger acquisitions. This would pose a significant competitive threat that would require other banks to respond.

History also shows that deals beget deals. Recent mega-mergers, such as Bank of America with FleetBoston, and J. P. Morgan Chase with Bank One, could well trigger a new round of intense global M&A activity as banks attempt to buy growth or cut costs by increasing scale. At the very least, banks will have to consider their M&A options to stay abreast of the competition, and window-shopping for opportunities often leads to buying.

## Make more, spend less

Revenue enhancement and cost-cutting are age-old issues and remain the primary drivers of M&A activity. According to a recent Citigroup Smith Barney study of M&As in the UK banking sector, expanding business scope can potentially lead to revenue synergies of more than 3% through

### Top Twenty Banks by Market Capitalization—1990, 2000, 2003 (\$bn)

1990			2000			2003		
Rank/Player	Region	Market Cap.	Rank/Player <sup>a</sup>	Region	Market Cap.	Rank/Player <sup>a</sup>	Region	Market Cap.
1. Industrial Bank of Japan	Asia	67.61	1. Citigroup	US	209.86	1. Citigroup (1)	US	210.86
2. Sumitomo Bank	Asia	55.81	2. Bank of America	US	94.86	2. HSBC Holdings (3)	Eur	126.97
3. Fuji Bank	Asia	53.17	3. HSBC Holdings	Eur	93.30	3. Bank of America (2)	US	111.06
4. Mitsui Taiyo Kobe Bank	Asia	49.80	4. Morgan Stanley Dean Witter	US	81.42	4. Wells Fargo (5)	US	81.72
5. Dai-ichi Kangyo Bank	Asia	49.47	5. Wells Fargo	US	74.88	5. Royal Bank of Scotland (15)	Eur	75.13
6. Mitsubishi Bank	Asia	47.17	6. Chase Manhattan	US	61.58	6. UBS (9)	Eur	67.63
7. Sanwa Bank	Asia	45.60	7. Lloyds TSB Group	Eur	59.25	7. J. P. Morgan Chase (6)	US	66.71
8. Nomura Securities	Asia	32.54	8. Bank of Tokyo—Mitsubishi (12, 6)	Asia	58.62	8. Wachovia	US	54.04
9. Long Term Credit Bank of Japan	Asia	32.44	9. UBS	Eur	57.71	9. Morgan Stanley (4)	US	49.67
10. Tokai Bank	Asia	23.52	10. ING Group	Eur	57.47	10. Barclays Bank (19)	Eur	46.19
11. Nippon Credit Bank	Asia	19.19	11. Credit Suisse Group	Eur	50.89	11. U.S. Bancorp	US	45.48
12. Bank of Tokyo	Asia	19.12	12. Deutsche Bank (13)	Eur	47.07	12. BNP Paribas (17)	Eur	44.33
13. Deutsche Bank	Eur	19.03	13. Nomura Securities (8)	Asia	45.03	13. HBOS	Eur	44.11
14. Sumitomo Trust & Banking	Asia	17.55	14. BBVA	Eur	43.36	14. Banc One (20)	US	43.51
15. Daiwa Securities	Asia	14.95	15. Royal Bank of Scotland	Eur	42.63	15. Lloyds TSB Group (7)	Eur	40.93
16. Daiwa Bank	Asia	14.23	16. Sumitomo Bank (2)	Asia	41.19	16. Merrill Lynch	US	40.28
17. Nikko Securities	Asia	13.37	17. BNP Paribas	Eur	40.39	17. BSCH (18)	Eur	38.59
18. Yasuda Trust & Banking	Asia	13.35	18. BSCH	Eur	39.97	18. Washington Mutual	US	38.56
19. Mitsui Trust & Banking	Asia	12.98	19. Barclays Bank	Eur	38.83	19. Deutsche Bank (12)	Eur	36.41
20. American Express	US	12.22	20. Banc One	US	37.92	20. Fifth Third Bancorp	US	33.22

Source: 1990: "The BusinessWeek Global 1000," *BusinessWeek*, 16 July 1990; 2000: *ibid.*, 10 July 2000; 2003: *ibid.*, 14 July 2003.

a. Numbers in parentheses indicate previous period rankings.

greater market share or diversification, and increased business scale can generate substantial cost-cutting opportunities that result in cost synergies exceeding 9%. Potential rewards of this magnitude can be very attractive.

### Geographic options

One way to categorize potential M&A opportunities is by their geographic characteristics—that is, domestic, cross-border, or global. For example, in domestic M&As, a local bank buys other local banks to become a national player. This strategy is most prevalent in countries with highly fragmented markets.

Cross-border M&A activity has historically started with strategic alliances and small purchases, rather than mega-mergers. In this way banks can establish a significant presence in other countries while avoiding any existing regulatory and political barriers to large deals. Initially a national player establishes a network of cross-border relationships, sometimes formalized by joint ventures or cross-shareholdings. The bank then expands its market presence by merging with or buying foreign partners to become a regional player. Banco Santander Central Hispano (BSCH, now Grupo Santander) successfully followed this strategic approach to take its place in the world's top twenty by establishing a leading consumer banking presence in Spain, Portugal, Germany, and Italy.

The dominance of the US and Europe in the current global financial services landscape means that most European and American banks enter new markets outside their region through transatlantic M&As. The Royal Bank of Scotland, for instance, made twenty-six US acquisitions from 1988 through 2004, and in the process has become the world's fifth largest bank by market capitalization. The Royal Bank of Scotland is not alone in its interest in the US market, which is attracting foreign suitors because of its large size, profitability, and high level of fragmentation. These primary factors also ensure that for now, at least, we expect US banks to see more incoming than outgoing transatlantic M&As.



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### Stages of Market Consolidation



## Market consolidation

The degree of market consolidation is a key factor when considering likely M&A opportunities and strategic choices. Domestic markets can be divided into three stages of consolidation based on the number of players and the percentage of market share they control.

### Domestic

A fragmented domestic market, such as the US, Italy, or Spain, where nine to twelve major banks control 50% of the market, clearly provides plenty of scope for consolidation. In developing markets such as France and Germany, with six to eight key players accounting for a 50%–80% market share, the number of retail banks is still decreasing as the market consolidates. In heavily consolidated markets, such as Canada, Belgium, and the UK, four or five major players hold 80% of the market. Regulations in such countries often impede further domestic consolidation, and banks may opt to look further afield at cross-border or transatlantic opportunities.

Even in highly consolidated markets, however, the overall number of banks continues to decline. Increases in scale or breadth of activity are still possible through domestic consolidation. In today's dynamic regulatory environment, large potential mergers in Italy, France, Germany, and even the UK are not out of the question. In the UK, especially, the growing case for bancassurance could be a key driver in domestic cross-market deals between banks and life insurance companies, as banks diversify in an effort to sustain their revenue growth in mature markets.

### Cross-border

Pan-European consolidation in the past has been hampered by diverse national regulatory and monetary systems, different financial products, and varying customers and cultures. As regulatory and cultural barriers have come down with the advent of a stronger European Union and the adoption of

the euro, cross-border consolidation in Europe is now on the rise. According to Dealogic LLC data, cross-border deals accounted for 40% of European financial services mergers and acquisitions in 2003, up from only 28% in 1999.

Germany's troubled banks, with their rising bad debts and high costs, are considered a primary target for cross-border deals. Dutch banks ABN AMRO and ING have already made acquisitions in this market. In November 2003, *Retail Banker International* reported that banks all over Europe and as far away as the US were rumored to be seeking M&A deals in Germany:

- BBVA, HSBC, Royal Bank of Scotland:
  - All three bidding for HVB's consumer credit unit, Norisbank
- BNP Paribas, Société Générale:
  - Publicly mentioned German expansion over the last two years
- Citigroup
- Credit Suisse Group
- Unicredito

According to the business press, several European banks are looking for M&A deals in other parts of Europe, namely in Spain and some central and eastern European countries:

- Barclays:
  - Was looking to buy Banco Atlantico, Spain's fifteenth largest bank with assets of €9.3bn.
- ABN AMRO:
  - Possible merger with Fortis Bank, ranked among the twenty largest financial institutions in Europe
- Nordea:
  - Apparently looking to create a single Scandinavian bank that spans Sweden, Finland, Norway, and Denmark
- Italian banks:
  - Central and Eastern Europe
- HBOS:
  - Ireland



### Global

Half of the top fifteen European banks are reportedly looking at US merger targets. However, domestic mega-mergers in the US, such as the Bank of America deal with FleetBoston, or J. P. Morgan Chase with Bank One, have some clear ramifications for future transatlantic deals on both seaboards. European banks with US operations will undoubtedly be affected by changes in the competitive landscape, such as Bank of America's success in developing a presence in nearly every US regional market. While competitors may benefit in the short term by picking off any disaffected customers these mega-mergers create, they will inevitably face even more intense competition and could be forced to expand their own geographic reach.

US targets can be expensive. Bank of America's decision to pay a 42% premium over FleetBoston's

share price indicates that US banks are unlikely to sell themselves cheaply, especially as signs of a global economic recovery emerge. The bar has been raised for acquisition prices in the US, and this could create a strong deterrent to European banks considering US partners, despite the favorable exchange rate they enjoy today.

Citigroup appears to be the only large US bank currently looking for merger opportunities in Europe. Due to the fragmented nature of the US market, most US players are focusing on domestic consolidation as their immediate priority. Yet unless US regulators increase the 10% limit on a bank's market share of US retail deposits, expanding players like Bank of America will find it difficult to pursue further large US mergers. As the market evolves, US banks could choose instead to look to Canada for cross-border deals.

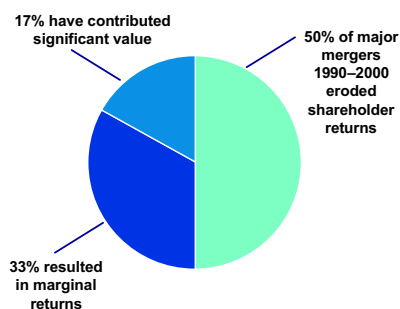
### Merger concerns

Most large mergers and acquisitions fall short of achieving the desired synergies. In January 1999, *The Economist* reported that study after study of past merger waves has shown that two of every three deals have not worked. According to a Merrill Lynch study in 2003, not only do most mergers fail to deliver their promised value, but large deals have tended to perform worse than smaller ones. And at least 50% of major mergers since 1990 have eroded shareholder returns.

Reasons for failed mergers are diverse and complex, but most can be attributed to losing something: critical people, customers, market confidence. Uncontrolled costs, hidden losses,

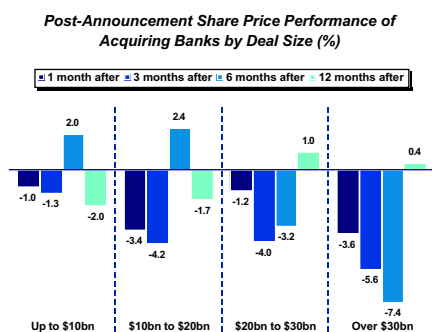
### Historic Value of M&As

#### Most Mergers Fail to Deliver Their Promised Value



Source: CGE&Y, "Alliances and Mergers Services for the Financial Services Industry," Feb. 2001.

#### Large Deals Have Tended to Underperform Smaller Deals



Source: Merrill Lynch, "AsiaPac Banknotes," 11 June 2003.

### Common M&A Critical Success Factors

Before . . .	. . . During, and After
<ul style="list-style-type: none"><li>• Seller is underperforming</li><li>• Buyer gets a good price</li><li>• Holding a minority stake in the target</li><li>• The time is right</li><li>• Expansion of core competence/high experience base</li><li>• Long-term commitment:<ul style="list-style-type: none"><li>– Capital infusion</li><li>– Prolonged break-even tolerance</li></ul></li><li>• Financial hurdles set up-front</li><li>• Strong brand</li><li>• Vision (clear value-creation logic)</li></ul>	<ul style="list-style-type: none"><li>• Having the right financial and nonfinancial measures</li><li>• Optimizing value-creation opportunities</li><li>• Strategic integration and restructuring:<ul style="list-style-type: none"><li>– Expertise in integration</li><li>– Rapid acceleration capability</li></ul></li><li>• Making the tough decisions</li><li>• Local management/expertise:<ul style="list-style-type: none"><li>– Benefit from market experience</li></ul></li><li>• Consistent management:<ul style="list-style-type: none"><li>– Execution and adherence to vision</li></ul></li><li>• Delivering on promises</li></ul>

Source: CGE&Y, "Alliances and Mergers Services for the Financial Services Industry," Feb. 2001.

unrealized benefits, avoiding decisions, cultural barriers, and power struggles can also undermine the most promising unions.

### Making mergers work

Despite the high failure rate, M&As that succeed can pay large dividends. HSBC's 1992 entry into Europe, when it acquired Britain's Midland Bank, is a good example. The successful restructuring resulted in a payback period of less than four years, and operating profits soared by more than 700%.

HSBC's success has been attributed to its preacquisition understanding of Midland and a well-conceived and executed post-acquisition integration process, reflecting many of the critical success factors common to M&As. The most successful acquiring firms have clearly established and well-understood acquisition processes, both for ensuring good strategic decisions before the acquisition decision is made and for integrating the acquired firm once the deal is complete.



# Why Choose Capgemini?

“Is there an appropriate target? Does it really fit our strategy? How do we organize and manage this effort?” These are just some of the difficult questions our clients face as we work with them in the M&A process. Capgemini works with you to understand your current position, where you want to go, and the best way to get there.

## Our approach

The M&A process can be distilled into five core components encompassing strategy, targeting, and transaction, followed by transition and transformation. In practice, the process is far from linear and consists of many interconnected and parallel activities. Capgemini provides a range of offerings to assist clients at key stages throughout

this process—before, during, and after the acquired firm is on board.

## Capgemini's track record

Capgemini today is the result of many mergers and acquisitions. Each of our legacy companies had an established M&A track record, and brought different yet complementary skill sets. Not only have we learned from our own acquisition experiences, our approach is also based on over thirty years of M&A best practice. Our experience base includes more than 300 national and international M&A projects across the entire spectrum of the M&A process. We have worked closely with some of the world's leading financial services institutions in achieving their M&A goals.



## About Capgemini and the Collaborative Business Experience

Capgemini, one of the world's foremost providers of Consulting, Technology and Outsourcing services, has a unique way of working with its clients, called the Collaborative Business Experience. Backed by over three decades of industry and service experience, the Collaborative Business Experience is designed to help our clients achieve better, faster, more sustainable results through seamless access to

our network of world-leading technology partners and collaboration-focused methods and tools. Through commitment to mutual success and the achievement of tangible value, we help businesses implement growth strategies, leverage technology, and thrive through the power of collaboration. Capgemini employs approximately 55,000 people worldwide and reported 2003 global revenues of 5.7 billion euros.



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