

Chapter 3 Cross-border bank M&A in Emerging Markets – Value creation or destruction?

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Introduction

This chapter considers the post-1998 wave of cross-border bank mergers and acquisitions activity involving purchases of stakes in target banks in emerging market economies (EME) by acquiring banks from industrialised countries (international banks). This international consolidation of the banking industry has followed hard on the heels of extensive domestic consolidation processes, which began in the US and Europe in the mid-1980s before spreading across EME in the 1990s and beyond (see Berger et al, 1999, 2000).³ Banking sector consolidation is one outcome of financial liberalisation and technological developments over the past quarter century. However, there are salient differences between the consolidation processes in industrial markets and EME: (1) cross-border M&A is a more important source of consolidation in EME; (2) consolidation is used to restructure EME banking sectors following episodes of financial crisis rather than to eliminate excess capacity; (3) governments in EME are active participants in the consolidation process (Gelos and Roldós, 2004).

Financial liberalisation - and technological developments - has stimulated cross-border M&A activity by changing public policy towards foreign bank entry and foreign ownership of domestic banks. From the early 1990s onwards, international banks have acquired ownership stakes in EME banks at an increasing pace. It is suggested that the international consolidation process reflects two events neatly dovetailing to equate market forces: (1) the intensification of competition in industrialised banking markets which forced international banks to look further afield geographically for opportunities to diversify risks and generate profits; (2) EME governments' deregulation of domestic banking sectors including the repeal of restrictions on foreign investment and foreign bank activities, and privatisation of state-owned financial institutions. The rising incidence of financial crises in EME in the mid-to-late 1990s highlighted a shortfall in domestic capital and the need to encourage foreign participation to recapitalise and consolidate domestic banking sectors. Thus, international banks had *demand* for access into new markets which EME could *supply*, and EME banking systems had *demand* for additional capital which international banks could *supply* (Cardias Williams and Williams, 2007).

Our principal objective is to empirically validate whether the present wave of internationalisation in the banking industry has created value for bank shareholders. Specifically, we carry out an event study analysis around the dates on which cross-border M&A transactions are announced, and calculate cumulative abnormal returns to shareholders. In so doing, we estimate how M&A

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³ The causes of the consolidation of US and European banking as well as the possible outcomes are discussed by various authors including Berger et al (1999), Berger (2000), Berger et al (2000), Berger et al (2001), Berger and DeYoung (2001, 2002), and Berger et al (2003).

transactions are valued by stockmarkets both in industrialised countries and EME, and also for the combined bank (joint abnormal returns are weighted by the market capitalisations of the acquiring and target banks). It is important not only to see if M&A create value, but also, how value is distributed between the two groups of shareholders. In previous studies of M&A in industrial banking markets, and in accordance with expectations, target bank shareholders received the greater proportion of the distribution of value. However, and worryingly from a public policy perspective, empirical evidence from the non-financial sector found that whereas the acquisition of majority control in EME firms created value for shareholders, the value gains were unevenly distributed in favour of shareholders of acquiring firms in industrialised countries (Chari et al, 2004). This implies a transfer of wealth from EME to already richer countries, and it will be informative to see if this characteristic is feature also of cross-border M&A in banking.⁴

Whether the announcement of cross-border bank M&A transactions generates value is an empirical issue. For this purpose, we have identified 74 M&A transactions involving the acquisition of stakes in 46 listed target banks in EME between 1998 and 2005, using M&A transactions reported in *Acquisitions Monthly* with additional information about transactions and participating banks sourced from Thomson Analytics Banker One, Datastream, and BankScope. The transactions take place in three regions: Latin America, Central and Eastern Europe, and Asia. In total, \$1,057,515 million of EME bank assets were sold for \$38,172 million (at 2000 prices). Over 56% of EME bank assets were sold in Asia but at a lower cost to acquiring banks compared to Latin America and CEE. The acquisition of stakes in Latin American banks accounted for more than 72% of the total value of M&A transactions with Latin bank assets the most expensive to buy.⁵

The remainder of the chapter is organised as follows. Section 2 reviews the internationalisation of the banking industry and considers issues pertaining to broader foreign bank penetration in EME. Section 3 presents the event study methodology. The construction of the sample and analysis of the data are discussed in Section 4. Section 5 discusses the abnormal returns to shareholders estimated using the event study methodology whilst Section 6 concludes.

International consolidation in banking

There is a substantial literature discussing why banks go abroad (see Heffernan, 2005). Traditionally, international banks have sought to exploit their comparative advantages over domestic counterparts in specific financial activities, or they have established branches to circumvent restrictions. The motives for M&A in terms of the present internationalisation of banking may be summarised as follows: (a) banks follow customers to new markets; (b) to increase earnings and diversify risk; (c) to exploit growth potential in host countries; (d) to circumvent limited growth opportunities in highly concentrated home markets; and (e) to realise efficiency gains (Slager, 2004). Point (e) is highlighted by several authors who claim that large

⁴ Although the volume of cross-border bank M&A activity in EME is not as extensive as in the non-financial sector - due partly to regulatory restrictions and information asymmetries/the opacity of bank value (Focarelli and Pozzolo, 2001) – the pace of M&A is increasing due to regulatory reforms and technological developments.

⁵ The assets of target banks, the value of deals, and cost per unit of asset for each region are as follows: Latin America (\$278,994m, \$27,578, \$0.0988); CEE (\$189,574m, \$5,049m, \$0.0266); Asia (\$588,947m, \$5,545m, \$0.0094). Source: own calculations from Thomson and BankScope data.

banks originating from competitive, well regulated domestic markets are more likely to expand overseas (Berger et al, 2000; Focarelli and Pozzolo, 2001). Indeed, cost efficiency is suggested to be more important than the overall degree of economic integration in explaining the internationalisation of the banking industry. A related stand of literature considers which EME are more likely to receive investment from international banks: large, relatively poor countries are targets for international banks using cross-border M&A to reach widely spaced populations; cross-border M&A is related positively to shared language and geographical proximity (Guillén and Tschoegl, 1999; Sebastián and Hernansanz, 2000; Buch and DeLong, 2001;); and, finally, relatively more open EME can be expected to receive a higher share of cross-border M&A activity (Buch and DeLong, 2001; Focarelli and Pozzolo, 2001).

During the 1990s, foreign direct investment became the largest single source of external finance for many EME (Goldberg, 2004). Prompted by financial liberalisation - bank privatisation⁶ and a relaxed treatment of foreign ownership - and the expansion into EME markets by corporate clientele, international banks increasingly penetrated EME. Survey evidence reports that this penetration by international banks has been achieved by the acquisition of ownership stakes in target banks rather than via establishment of a branch or subsidiary (BIS, 2004).⁷

The pattern of foreign bank entry, however, is uneven and reflects intertemporal differences in regulatory reforms across EME: Latin American and Central and Eastern Europe (CEE) EME have allowed and received the most foreign bank entry (Clarke et al, 2003). Foreign bank shares of total banking system assets has rapidly increased over time with foreigners controlling the majority of banking assets in some Latin and CEE markets (see Clarke et al, 2003; Barth et al, 2001, Bonin et al, 2005).⁸ The resolution of EME financial crises involved the implementation of policies that – at the very least – have offered a more liberal treatment of foreign ownership that has stimulated an increase in cross-border M&A transactions. This is most certainly the case in Asia. In 1996, the degree of financial openness varied across South East Asia. The most restrictive rules on foreign bank activity were found in Korea, Malaysia and Thailand. Following the 1997 financial crisis, national banking laws have been amended to liberalise the treatment of foreign banks to such an extent that there are no longer any restrictions on foreign acquisition of majority stakes in domestic banks in Indonesia, Korea, and Thailand.⁹

It is informative to consider why the acquisition of ownership stakes in EME target banks by international banks would influence stockmarkets' valuation of returns, first, for the acquiring bank, and, second, the target bank. As noted above, greater competitive pressure in industrialised banking systems has forced banks to seek out new, profitable investment strategies in other

⁶ See Megginson (2005) for a review of the bank privatisation literature and a list of privatised banks.

⁷ Purchasing an established branch network is one mode through which acquiring banks access underdeveloped, but potentially large, retail banking markets that exist in EME. Other investment options include taking a minority stake in a target bank and increasing it over time, or entering into a joint venture agreement. We note that hostile takeovers in banking are very rare and foreign bank takeovers are subject to regulations which vary between countries.

⁸ Barth et al (2001) provide an exhaustive source for the proportion of banking system assets held by foreigners in nearly 100 countries.

⁹ For a fuller discussion of the resolution strategies adopted in SE Asia we refer the interested reader to references cited in Williams and Nguyen (2005), whereas for a review of recent developments in Asian banking we draw readers' attention to Nguyen and Williams (2007).

markets (BIS, 2004). EME, although they tend to be perceived as higher-risk, higher expected return investments, offer considerable opportunities for expanding bank credit and sourcing of relatively cheap customer deposits. EME entry can diversify earnings streams and risks for acquiring banks. However, stockmarket valuations of M&A transactions consider the expected future profitability of the investment. Indeed, there is evidence that the decision to retreat from international markets is valued more highly by stockmarkets than lowly profitable international investments (Slager, 2004). To make valuation more complex, evaluations of expected profitability are influenced by perceptions of country risk – especially political risk – expectations of the acquiring bank’s future strategy in the EME, and the structure of the host banking system.¹⁰

Some empirical evidence finds foreign banks are more efficient than domestic banks in EME with foreign bank entry conditioning the behaviour of domestic banks; in other words, foreign competition leads to lower margins, profits, and overhead costs at domestic-owned banks (Claessens et al, 2001). It is uncertain how stockmarkets would value an increase in competitive conditions in EME banking systems given international banks’ strategic goals of exploiting arbitrage opportunities and specialising in market segments where they hold comparative advantage over domestic banks. The implementation of international best practice and technology is expected to raise efficiency in the target bank and it is reasonable to assume that investors’ value improving bank efficiency. However, we note several important caveats. First, there are suggestions that foreign ownership stakes need to be very large (over 70%) if a target bank is to be successfully restructured and achieve improvements in cost efficiency (Claessens and Jansen, 2000). Second, Berger et al (2000) emphasise the existence of diseconomies arising from operating a subsidiary at distance which may prevent foreign-owned banks from operating efficiently.¹¹ Berger et al note that such diseconomies are more likely to be overcome by acquiring banks that originate in highly competitive and well regulated environments.

There may be hostility in EME markets towards foreign ownership of domestic banks. Market reaction could reflect sentiments towards the sale of national champions which maybe perceived as a loss of cultural identity; there could be concerns about the future strategy for the target bank; foreign banks are often thought to lack loyalty to the host EME and exit in times of financial distress; domestic banks may lose market share because they cannot compete effectively against better resourced foreign-owned banks. On the contrary, the market may value so-called reputation effects, if the acquiring bank is a renowned financial institution, and the re-branding of [often formerly troubled] domestic banks. Foreign bank entry is associated with an improvement in the range and quality of financial products and services, and an improvement in the regulatory and supervisory environment in the EME (see Clarke et al, 2003).

Event study methodology

The established literature on bank M&A has three strands. First, event studies ascertain if M&A deals generate value (abnormal returns) for bank shareholders around announcement date;

¹⁰ This type of evaluation is a complex task owing to informational asymmetries and data availability.

¹¹ Operational diseconomies associated with distance are heightened by barriers relating to the following: culture, language, currency, the host regulatory and supervisory structure, and explicit and/or implicit rules against foreign banks (Berger et al, 2000).

studies investigate intra financial industry deals, cross-border deals, and pre-and-post risk valuation (see Cybo-Ottone and Murgia, 2000; DeLong, 2001; Amihud et al, 2002). Generally speaking, there is mixed evidence from the US (see Pilloff and Santomero, 1998). The evidence suggests value gains are distributed in favour of target bank shareholders at the expense of acquiring bank shareholders (Berger et al, 1999), but gains accruing to target bank shareholders are offset by value destruction for acquiring bank shareholders, which means there are insignificant joint returns to the combined bank (Houston and Ryngaert, 1994). Whilst the number of European studies is limited, they do offer a cross-border perspective. Contrary to US experience, the empirical record states that M&A transactions in Europe add significant value. Gains accrue to target bank shareholders with no significant value destruction for acquiring bank shareholders (Cybo-Ottone and Murgia, 2000; Beitel and Schiereck, 2001).

In the second strand of literature, bank operating performance (measured by ratios or estimated efficiency) is compared pre-and-post merger (see, for instance, Altunbaş and Marqués Ibáñez, 2004; Humphrey and Vale, 2004). A review of several studies reports that on average there are no cost efficiency gains accruing from M&A, although cost efficient banks with superior management are expected to raise efficiency in acquired banks (Berger and Humphrey, 1997). However, sizable profit efficiency gains do accrue when large banks merge (Akhavain et al, 1997). Neither of the two strands explains the motives underlying bank M&A. This issue is considered by a third literature which uses discrete outcome methods to model the probability of M&A given a set of covariates (see Cardias Williams and Williams, 2007, for an overview of this literature). Since our objective is to quantify whether the announcement of cross-border M&A transactions creates value, the current study belongs to the first category. The methodology for the event study is described in the following paragraphs.

The calculation of abnormal share price returns implies we consider only listed banks in our sample of cross-border M&A transactions. (It should be noted at this point that a number of cross-border M&A deals have involved non-listed banks.) Whilst this is a limitation of the event study methodology – especially in comparison with dynamic efficiency studies – nevertheless, the exercise and its objectives remain vitally important as an analysis of market behaviour and wealth generation effects. Share price returns are calculated as the logarithmic difference between the share price index at day t and day $t-1$. The market model – see equation [1] - is used to estimate alpha and beta over an estimation period which spans -392 days to -130 days before the M&A announcement is made (on day 0). Although the choice of estimation period is arbitrary, we select a period commencing eighteen months and ending six months before the announcement date in order not to bias the estimates of alpha and beta with expectations of an impending M&A transaction. Abnormal returns to bank shareholders are measured as the difference between actual returns and predicted returns; the latter is derived using (constant) estimates of alpha and beta from OLS estimation of the market model (see Brown and Warner, 1985). Following convention, abnormal returns to target bank shareholders and acquiring bank shareholders are calculated.

The market model [1] is estimated for each target bank and acquiring bank. We select national stockmarket indexes as measures of the market but note that other authors have used national banking sector indexes and even the world banking sector index.

$$AR_{it} = R_{it} - \left[\hat{\alpha}_i + \hat{\beta}_i * R_{mt} \right] \quad [1]$$

where AR_{it} is the abnormal return and R_{it} the raw return to bank i at time t ; R_{mt} is the return to the stockmarket m at time t ; $\hat{\alpha}_i$ is the estimated intercept and $\hat{\beta}_i$ the estimated beta which shows the sensitivity of the returns to each bank to stockmarket returns.

The Brown and Warner (1980) t test statistic is used to determine if cumulative average abnormal returns are statistically significant. For day 0 the test statistic is given by:

$$\frac{\frac{1}{N} \sum_{i=1}^N AR_{i0}}{\frac{1}{N} \left(\sum_{i=1}^N \left[\frac{1}{261} \sum_{t=-392}^{-130} (AR_{it} - \left(\frac{1}{262} \sum_{t=-392}^{-130} AR_{it} \right)) \right]^2 \right)^{\frac{1}{2}}}$$

A measure of joint returns to the combined bank is constructed by summing the weighted abnormal returns to target and acquiring bank shareholders; returns are weighted by the respective shares in combined market capitalisation. In order to better approximate returns to international investors, returns are denominated in US dollars (except in a few cases where returns denominated in domestic currency are used. In all cases, market capitalisation is dollar-denominated). Cumulative average abnormal returns are calculated across different event windows: symmetric and non-symmetric window lengths account for features such as thin trading in EME stock markets and leakage effects prior to official announcements. *A priori* a positive abnormal return implies stockmarkets expect value to be created by M&A activity whilst negative returns imply value destruction. Given that the size of acquiring banks tends to be considerably greater than the target banks, we expect joint returns will be driven by abnormal returns to acquiring banks.

Construction of Sample and Data

We compiled the sample of M&A transactions after searching *Acquisitions Monthly* and identifying cross-border transactions involving acquiring international banks and target banks from EME. The 74 transactions precipitated an exchange of ownership rights in 46 EME banks. To supplement our analysis, we sourced information about each transaction from Thomson One Banker Analytics which contains the SDC Mergers and Acquisitions database. We collected data on the value of the transaction, the percentage stake acquired in each transaction – which enabled us to establish a cumulative stake and classify the five types of acquisition with a dummy variable. Additional information was collected on the dollar price paid per share and the method of acquisition (open market purchase, tender offer, privately negotiated purchase, divestitures, stock swap, privatisation, other).

The individual M&A transactions are listed in Table 3.1. Columns 1 and 2 show the name and country of the target banks with comparative information for the acquiring banks in columns 3 and 4. Column 5 shows the size of ownership stakes following the transactions; the reader should

understand that in several instances acquiring banks already held a stake in target banks, and that the acquisition we consider represents an additional purchase of ownership rights. Frequently, international banks have acquired stakes in their targets via multiple acquisitions, and this is indicated by the Yes/No classification in column 6. Finally, the value of the transactions in US \$ millions at 2000 prices is shown in column 7.

The data are segmented by the three EME regions under consideration. Some general points emerge: the increasing penetration of Latin and CEE banking sectors by international banks; the relatively recent penetration of Asia; the considerable difference in value expended by international banks in acquiring ownership stakes in Latin American banks in comparison to CEE and Asian banks; the entry of Spanish banks into Latin America (consistent with the shared language and culture hypothesis); the entry of Western European banks into CEE markets (consistent with the proximity hypothesis); and few truly international players: between 1998 and 2005, only four international banks acquired stakes in banks in more than one EME region: a US bank (Citibank), a UK bank (HSBC), and two Dutch banks (ABN Amro and ING).

Table 3.1 Sample of targets & acquiring banks, 1998-2005

<i>Target</i>	<i>Country</i>	<i>Acquirer</i>	<i>Country</i>	<i>Stake %</i>	<i>> 1</i>	<i>Value \$m</i>
Latin America						
Banco Rio de la Plata	Argentina	Merrill Lynch	US	18.54	No	261.20
Banco Rio de la Plata	Argentina	BSCH	Spain	79.83	Yes	783.00
Banco Frances	Argentina	BBVA	Spain	100.00	Yes	1,138.64
Banespa	Brazil	BSCH	Spain	97.10	Yes	4,847.60
Banco Sudameris Brazil	Brazil	ABN AMRO	Netherlands	94.57	No	712.30
Banco Real	Brazil	ABN AMRO	Netherlands	80.00	Yes	2,833.48
Banco Santander Chile	Chile	BSCH	Spain	78.90	No	671.52
BHIF	Chile	BBVA	Spain	62.96	Yes	387.37
Sud Americano	Chile	ScotiaBank	Canada	60.20	No	118.22
Ganadero	Colombia	BBVA	Spain	95.16	Yes	477.49
Banco Santander Colombia	Colombia	BSCH	Spain	88.50	No	74.10
Banamex	Mexico	Citigroup	US	99.86	No	12,520.63
Serfin	Mexico	JP Morgan	US	8.60	No	70.49
BITAL	Mexico	HSBC	UK	99.59	No	1,089.10
BITAL	Mexico	BSCH	Spain	26.60	No	81.58
Bancomer	Mexico	BBVA	Spain	30.00	No	1,400.00
Banco Provincial	Venezuela	BBVA	Spain	49.50	No	106.97
Central and Eastern Europe						
Ceska Sporitelna	Czech	Erste	Austria	87.90	Yes	1,158.50
Zivnostenska banka	Czech	BankGes	Germany	100.00	Yes	31.60
Komerčni Banka	Czech	SocGen	France	60.35	No	996.10
Inter-Europa Bank	Hungary	IMI San Paolo	Italy	85.26	No	23.80
Bank Slaski	Poland	ING	Netherlands	87.70	Yes	345.80
Bank Handlowy	Poland	Citigroup	US	87.83	Yes	969.50
Bank Amerykanski	Poland	DZ Bank	Germany	58.00	No	37.52
BPH Bank	Poland	Hypo Bank	Germany	81.46	Yes	956.19
Kredyt Bank	Poland	KBC	Belgium	76.46	Yes	340.97
Bank Wspolpracy Reg.	Poland	Deutsche Bank	Germany	89.20	No	58.85
SKB Bank	Slovenia	SocGen	France	96.46	No	130.47
Asia						
Ping An	China	HSBC	UK	19.90	No	929.70
Shanghai Pudong Dev.	China	Citigroup	US	5.00	No	69.49
Uti Bank	India	Citigroup	US	16.67	No	32.45
Uti Bank	India	HSBC	UK	14.62	No	64.53
Vysya Bank	India	ING	Netherlands	43.99	Yes	67.91
HDFC Bank	India	Deutsche Bank	Germany	3.75	No	146.87
Pan Bank	Indonesia	ANZ	Australia	4.90	No	3.07
Bank Buana Indonesia	Indonesia	UOB Bank	Singapore	23.00	No	105.41
Bank Permata	Indonesia	Std. Chartered	UK	62.20	No	64.90
Bank Lippo	Indonesia	Swiss First	Switzerland	52.05	No	131.99
Korea Exchange Bank	Korea	Commerzbank	Germany	32.50	Yes	432.74
Kookmin Bank	Korea	Goldmans	US	17.00	No	479.91
Shinhan Financial Group	Korea	BNP Paribas	France	4.00	No	118.65
KorAm	Korea	Citigroup	US	97.50	No	1,500.84
KorAm	Korea	Std. Chartered	UK	9.76	No	144.87
H&CB	Korea	ING	Netherlands	10.00	No	286.81
Far East Bank & Trust	Philippine	DBS Bank	Singapore	7.40	No	92.68
Asia Plus Securities	Thailand	ABN AMRO	Netherlands	100.00	No	93.41
Bank of Asia	Thailand	UOB Bank	Singapore	96.10	Yes	778.52

Source: Thomson Banker One Analytics

The distribution of M&A transactions is shown in Table 3.2. The data are constructed to show acquisitions by European, North American, and developed Asian banks in the three EME regions: Latin America, Central and Eastern Europe, and Asia. The following features emerge: European banks have been more active purchasers of emerging market bank assets using M&A as a point of entry into these markets. European banks acquired 34 EME banks over 58 separate transactions for \$21,565 million whilst US banks acquired 9 banks over 11 deals for \$16,480 million. This partly reflects strategic decisions by some US banks with existing presence in emerging markets to concentrate on organic growth rather than engaging in M&A.

Table 3.2 Distribution of M&A transactions; by Region, 1998-2005

	No. of deals	No. of targets	Value, \$ m	Share of value, %	Average value, \$ m
EUR-CEE	18	10	4,144.00	10.86	230.22
EUR-LAT	26	12	14,601.80	38.25	561.61
EUR-ASIA	14	12	2,819.00	7.39	201.36
Asia-Asia	5	3	852.80	2.23	170.56
NA-CEE	3	1	969.50	2.54	323.17
NA-LAT	4	4	13,265.90	34.75	3,316.48
NA-ASIA	4	4	2,244.30	5.88	561.08
Total EME	74	46	38,171.65	100.00	515.83

Source: Thomson Banker One Analytics

European (excluding Spanish) banks have acquired stakes in CEE targets whilst Spanish banks acquired stakes in Latin America (Argentina, Chile, Colombia, Mexico and Venezuela). The Spanish acquisitions accounted for 36% of the value of all M&A transactions in Latin America whereas the acquisition of stakes in two Mexican banks by two US banks accounted for 47%. The data suggest European, US, and developed-Asian nation banks are establishing a presence in Asian markets. European banks have acquired stakes in 12 Asian banks whilst US banks and banks from developed Asia acquired stakes in four banks each. More than 56% of the total value of Asian M&A transactions has been spent on acquiring stakes in Korean banks. Although there are restrictions on foreign ownership, international banks have started to acquire stakes in Chinese and Indian targets: we suspect further stakes will be acquired by other banks and stakes will increase when current restrictions are lowered.

Table 3.3 Distribution of M&A transactions; by Ownership Stake, 1998-2005

Holding	Value, \$ m	% share	Average, \$ m	Deals
D1 – acquire majority (> 50%)	81,608	7.72%	6,278	13
D2 – acquire minority (< 50%)	520,438	49.21%	30,614	17
D3 – increase minority (from $n < 50%$ to $< 50%$)	114,202	10.80%	11,420	10
D4 – minority to majority (from $< 50%$ to $> 50%$)	152,557	14.43%	10,170	15
D5 – increase majority (from $n > 50%$)	188,710	17.84%	9,932	19

Source: Thomson Banker One Analytics

The data are organised according to the size of ownership holdings in Table 3.3. It shows how international banks enter emerging market banking sectors. Based on the percentage stake acquired in each transaction and the cumulative stake held, we suggest international banks follow five modes of entry: (1) acquisition of majority stake (13 cases); (2) acquisition of minority stake (17 cases); (3) increasing existing minority stake (10 cases); (4) increasing minority stake to majority stake (15 cases); and (5) increasing majority stake (19 cases). Banks increasingly penetrated Latin American and CEE banking systems between 1998 and 2005; cumulatively, they acquired majority control, increased from minority to majority control, or increased majority stakes in 90.48% and 70% of transactions with Latin American and CEE targets, respectively. On the contrary, international banks acquired minority stakes in 52.17% of M&A transactions with Asian targets; the acquisition of majority control was made only in 17.39% of transactions.

Results

We present the estimated cumulative abnormal returns according to several criteria: by EME region; size of ownership stake; method of acquisition; and the nationality of the acquiring bank. Returns to target, acquirer, and combined bank shareholders are shown for seven different sized event windows. As expected and consistent with theoretical expectations, abnormal returns to target bank shareholders are higher than returns to acquiring bank shareholders. However, due to the fact that the acquiring international banks are considerably larger than their targets, it is the returns of the former which drive joint weighted returns. How do the abnormal returns to EME banks and their acquirers compare with those found elsewhere in the literature? Generally speaking, the size of abnormal returns to US and European targets tend to be higher than the returns to target banks in EME which we have calculated. For instance, Beitel and Schiereck (2001) report cumulative abnormal returns to European targets of 11.38%, 13.54% and 14.39% for the following event windows [-2, 0], [-2, +2] and [-10, +10]. Similar sized returns have been found in studies of US M&A. In terms of cumulative returns to acquiring banks, our results are consistent with the US and European results; returns are small and often negative. There is mixed

evidence of value gains and losses to combined banks from the US whilst European evidence points to significant value gains. Whereas the evidence from EME is more consistent with US results, we note that joint returns to combined EME/international banks are driven by returns to considerably larger acquiring banks.

Cumulative abnormal returns are presented by region (see Table 3.4). Returns to target bank shareholders are considerably greater in Latin America compared with the CEE and Asia. Latin returns are significantly large across all window lengths whereas returns are significant only for shorter window lengths for Asian banks and CEE banks. Although Latin stockmarkets expect value to be created from cross-border bank M&A activity, international stockmarkets appear not to share this sentiment since we observe significant value destruction. On the contrary, international stockmarkets expect M&A activity involving CEE and Asian banks much more favourably: returns to acquiring bank shareholders are significantly positive, in the main, for CEE and Asian banks; returns are less than 1% for acquisitions of stakes in Asian banks, and range between 1-1.5% at CEE banks (for longer window lengths only). We find significant joint returns to combined banks of around 1% for transactions involving CEE banks (at longer window lengths), whilst smaller, yet significant joint returns from 0.5 to around 1% are found for deals involving Asian targets (at shorter window lengths).

Table 3.4 Cumulative Average Abnormal Returns; by Region (%)

Region	Latin America	CEE	Asia	All Regions
<i>Returns to Target banks</i>				
CAR[-2,0]	4.1956***	0.2663	1.1356**	2.1294***
CAR[-2,1]	3.4930***	1.7890***	1.9309***	2.5239***
CAR[-2,2]	4.5312***	2.9803***	1.7866***	3.2380***
CAR[-10,-1]	3.7582***	0.4946***	0.0152	1.6687***
CAR[-10,2]	7.0863***	2.8545	1.3803	4.1119***
CAR[-10,10]	6.6369***	0.6378***	-0.1898	2.8126***
CAR[-15,15]	4.8556***	0.6680***	-2.6770***	1.3260***
<i>Returns to Acquiring banks</i>				
CAR[-2,0]	-0.2316***	0.4707**	0.1612	0.0898
CAR[-2,1]	-0.4768***	0.3019	0.6866***	0.1058
CAR[-2,2]	-1.3955***	0.3554**	0.6850***	-0.2520***
CAR[-10,-1]	-0.5872***	1.1775***	0.3413***	0.2022***
CAR[-10,2]	-1.9476***	1.5660	0.8849	-0.0701
CAR[-10,10]	-1.4748***	1.2006***	0.2923***	-0.1663***
CAR[-15,15]	-0.4500***	1.4461***	0.3624***	0.3406***
<i>Returns to Combined banks</i>				
CAR[-2,0]	-0.0939	0.2461	0.5987***	0.2178**
CAR[-2,1]	-0.3465***	0.1346	1.0795***	0.2333***
CAR[-2,2]	-1.1443***	0.1598	1.0582***	-0.0897
CAR[-10,-1]	-0.5852***	1.3829***	0.6440***	0.3554***
CAR[-10,2]	-1.7145***	1.6281	1.2344	0.1506
CAR[-10,10]	-1.2377***	0.7292***	0.3775***	-0.1775***
CAR[-15,15]	-0.5178***	0.9203***	-0.1769***	-0.0037

***, **, * statistically significant at 1%, 5% and 10%, respectively

The returns data are expressed according to the size of stake acquired by international banks (see Table 3.5). The largest returns to target banks are found when international banks acquire majority control (D1 – but only in the longer windows) and when they increase an existing minority stake (D3 – but only in the shorter windows). However, and somewhat surprisingly, the purchase of stakes which convert international banks’ minority holding to a majority yields significant negative returns in all but two windows. This might reflect sentiment at the loss of “national” assets or former champions. The returns to acquiring banks tentatively suggests that stockmarkets positively value both acquisition of majority control (D1) and increase in existing majority holdings (D5) in the case of EME bank investments. This produces a joint return of more than 1% when existing majority stakes are increased whilst acquisition of majority control yields mainly insignificant returns.

Table 3.5 Cumulative Average Abnormal Returns; by Ownership Stake (%)

Ownership stake	D1	D2	D3	D4	D5
<i>Returns to Target banks</i>					
CAR[-2,0]	2.4169***	2.7961***	6.9518***	-2.3316***	2.5587***
CAR[-2,1]	2.9182***	4.9108***	7.1732***	-4.1859***	3.1925***
CAR[-2,2]	3.6316***	5.1096***	6.1181***	-2.2720***	4.2592***
CAR[-10,-1]	2.4801***	1.9561***	-1.2313***	3.6303***	0.6386***
CAR[-10,2]	6.4345**	5.3357*	3.6286	1.8554	3.3160
CAR[-10,10]	6.0599***	2.3688***	2.7149***	-0.5075***	3.4845***
CAR[-15,15]	5.7613***	1.0143***	0.3096*	-4.7002***	3.5758***
<i>Returns to Acquiring banks</i>					
CAR[-2,0]	0.2023	-0.6311***	-0.0381	0.8081***	0.1454
CAR[-2,1]	0.0838	-0.4491**	0.1679	0.4167**	0.3437**
CAR[-2,2]	0.3756**	-0.5785***	0.1667	-1.1572***	0.0940
CAR[-10,-1]	0.5860***	-0.7914***	-0.0146	-0.7747***	1.6822***
CAR[-10,2]	1.3470	-1.1116	0.1472	-2.7378**	1.8207
CAR[-10,10]	0.8597***	-1.1161***	0.1583	-2.3595***	1.5050***
CAR[-15,15]	1.9112***	-0.4949***	1.8381***	-3.7975***	2.4883***
<i>Returns to Combined banks</i>					
CAR[-2,0]	-0.3105	0.2524	0.2462	0.7831***	0.1165
CAR[-2,1]	-0.5026**	0.4670**	0.5189**	0.4549**	0.2561
CAR[-2,2]	-0.3011*	0.3401**	0.6188***	-0.9871***	0.0544
CAR[-10,-1]	0.6242***	-0.1616	-0.3410**	-0.2245*	1.4075***
CAR[-10,2]	0.6737	0.0671	0.0053	-1.9045	1.5312
CAR[-10,10]	0.0006	-0.0063	0.1027	-2.3346***	1.1083***
CAR[-15,15]	0.5172***	0.1789***	1.9470***	-4.0382***	1.7103***

Note:

D1 indicates the acquisition of majority control.

D2 indicates the acquisition of a minority stake.

D3 indicates the increase of an existing minority stake.

D4 indicates increased ownership from minority to majority.

D5 indicates increasing an existing majority stake.

***, **, * statistically significant at 1%, 5% and 10%, respectively.

Tables 3.6 and 3.7 examine returns by the method of acquisition and nationality of acquiring bank. Target returns similar in size to those reported by Beitel and Schiereck (2001) for European banks (see above) are found when emerging market banks are acquired via a tender offer. Returns to targets are relatively large when the method of acquisition is a stock swap, and privately negotiated purchase albeit to a lesser extent. Surprisingly, open market purchases of bank stock leads to very large, negative returns; privatisation also yields negative returns. The data show that only privately negotiated purchases produce a positive and mostly significant gain to acquiring banks and this generates a joint return of around 1% across the different window lengths (see Table 3.6).

Table 3.6 Cumulative Average Abnormal Returns; by Type of Acquisition (%)

Type of acquisition	Open market	Tender offer	Private neg	Stock swap	Privatisation	Other
<i>Returns to Target banks</i>						
CAR[-2,0]	-2.0118***	4.6940***	2.2928***	7.7097***	-1.5879**	-1.3096**
CAR[-2,1]	-4.5644***	7.8447***	3.5198***	6.8984***	-1.3480**	-4.2166***
CAR[-2,2]	-6.4300***	10.7396***	3.5606***	7.0092***	-0.4255	-4.5170***
CAR[-10,-1]	-2.9657***	3.3416***	0.6299***	0.4390	-4.2846***	9.0138***
CAR[-10,2]	-9.4030**	13.3619***	3.3040	7.2275*	-3.5229	3.9823
CAR[-10,10]	-9.8522***	11.0897***	2.9383***	8.7419***	-4.5922***	2.3351***
CAR[-15,15]	-12.6598***	10.0020***	0.7579***	8.2070***	-2.9548***	0.5432***
<i>Returns to Acquiring banks</i>						
CAR[-2,0]	0.4633**	0.0016	0.0730	-0.7475**	-0.1092	0.4784
CAR[-2,1]	0.3112*	-0.4783***	0.2909**	-1.3366***	-1.3942***	1.4877***
CAR[-2,2]	-1.0926***	-1.0114***	0.4461***	-2.6575***	-2.9978***	1.8375***
CAR[-10,-1]	-1.3066***	0.5443***	0.8591***	-0.7567***	-0.1404	-0.6956***
CAR[-10,2]	-2.8093**	-0.3054	1.1716	-3.4109*	-4.4129	1.4388
CAR[-10,10]	-3.8709***	0.9899***	0.9698***	-1.8820***	0.5683***	-0.2147*
CAR[-15,15]	-5.3909***	1.7810***	0.7895***	-2.8470***	3.3347***	1.5013***
<i>Returns to Combined banks</i>						
CAR[-2,0]	0.4449**	0.0410	0.5820***	-0.6549**	-0.8367*	0.3096
CAR[-2,1]	0.0913	-0.2526	0.8588***	-1.2904***	-2.2647***	1.2497***
CAR[-2,2]	-1.1817***	-0.6017***	0.9669***	-2.5193***	-3.7747***	1.3945***
CAR[-10,-1]	-1.5184***	0.9406***	0.9998***	-0.5711***	-0.5247**	-0.1497
CAR[-10,2]	-3.1646**	0.4778	1.6615	-2.9163	-5.2094*	1.2178
CAR[-10,10]	-4.6591***	1.0722***	1.3550***	-1.7893***	0.2993*	0.0280
CAR[-15,15]	-6.3224***	1.9977***	0.7282***	-2.6438***	2.9261***	0.6432***

***, **, * statistically significant at 1%, 5% and 10%, respectively.

Finally, returns are presented according to the nationality of the acquiring bank in Table 3.7. Win-win situations are found when US banks and Dutch banks acquire an emerging market target (but not in all windows). There is a contrast in the joint returns: returns are positive and high for longer window lengths for US banks but negative for Dutch banks: yet, returns across the shorter windows are positive and significant for Dutch banks. Whereas UK bank and Spanish bank purchases yield significant returns to target banks, the joint returns are significantly negative due to unfavourable stockmarket reactions in Spain and the UK.

Table 3.7 Cumulative Average Abnormal Returns; by Nationality of Acquirer (%)

Nationality of Acquirers	US	European	Dutch	Spain	UK
<i>Returns to Target banks</i>					
CAR[-2,0]	2.1186***	-0.7347**	3.7503***	2.7291***	5.9066***
CAR[-2,1]	1.5013***	0.3104	6.3440***	2.2118***	4.1524***
CAR[-2,2]	1.2516***	0.9241***	6.9481***	3.7130***	5.2814***
CAR[-10,-1]	3.9580***	0.3125	-3.3150***	2.6099***	5.0400***
CAR[-10,2]	4.3399	1.4086	2.7302	4.7721**	9.9604
CAR[-10,10]	6.2277***	-1.9934***	2.8828***	3.9360***	8.2538***
CAR[-15,15]	3.1551***	-0.3803***	-2.2800***	2.0635***	7.9943***
<i>Returns to Acquiring banks</i>					
CAR[-2,0]	-0.3344	0.2222	0.9572***	0.0693	-0.7539***
CAR[-2,1]	-0.0713	-0.0656	1.9295***	-0.3842**	-1.0611***
CAR[-2,2]	0.0285	0.0142	1.7617***	-1.5606***	-0.8849***
CAR[-10,-1]	1.3583***	1.1437***	0.1932	-1.1833***	0.0605
CAR[-10,2]	1.6947	1.2388	1.3968	-2.8478***	-1.3408
CAR[-10,10]	0.9634***	1.3205***	-0.2687***	-2.1750***	-0.6513***
CAR[-15,15]	1.6219***	1.9707***	0.0161	-1.1362***	-0.8978***
<i>Returns to Combined banks</i>					
CAR[-2,0]	-0.2599	-0.0157	0.5234**	0.1433	-0.5483**
CAR[-2,1]	0.0045	-0.2529	1.3928***	-0.3234**	-0.8090***
CAR[-2,2]	0.1900	-0.2234	1.1576***	-1.3506***	-0.6294***
CAR[-10,-1]	1.3454***	1.4302***	-0.0939	-1.3664***	0.1900
CAR[-10,2]	1.8303	1.2315	0.6351	-2.7923***	-1.0466
CAR[-10,10]	1.1589***	0.9609***	-1.5693***	-1.9487***	-0.8071***
CAR[-15,15]	1.9586***	1.4266***	-1.6333***	-1.2832***	-0.7689***

Note: European excludes transactions involving Dutch, Spanish and British banks.

***, **, * statistically significant at 1%, 5% and 10%, respectively.

Conclusion

We construct a sample of cross-border bank M&A transactions between international banks and target banks in EME covering 74 transactions involving 46 targets between 1998 and 2005. The transactions involved a small number of acquiring European and US banks, and targets from Latin America, CEE, and Asia. The chapter contributes to the literature on the internationalisation of banking by analysing stockmarket reactions to cross-border bank M&A involving banks from EME and industrialised countries.

Our analysis of cumulative average abnormal returns shows some consistency with results obtained from the US and Europe, as well as with theoretical expectations. Generally, returns to target bank shareholders are positive implying that EME stockmarkets perceive cross-border bank M&A activity to be value generating. There are exceptions when negative abnormal returns are found. These findings, however, may be explained by specific characteristics of M&A transactions such as the conversion from minority foreign ownership to majority and the

privatisation of EME banks. Nevertheless, the magnitude of returns to target bank shareholders tends to be larger than returns to acquiring bank shareholders. This suggests there is no evidence of wealth being transferred from EME to industrialised countries in cross-border bank M&A transactions between 1998 and 2005. In other words, our results are opposite to those of Chari et al (2004) for the non-financial sector.

The results suggest that international stockmarkets react somewhat differently than EME stockmarkets to cross-border bank M&A activity. Aside from abnormal returns being smaller, often they are significantly negative, which implies cross-border M&A is perceived to be value destructive. This is the case when international banks acquire Latin American banks, when international banks increase minority stakes or convert minority ownership into majority holdings, and when targets are acquired via open market purchase and a stock swap. On the contrary, cross-border M&A is viewed as value creating when international banks acquire stakes in CEE and Asian targets, when majority stakes are purchased or increased, and when stakes are purchased via private negotiation. The US, European (excluding Spain and the UK) and Dutch stockmarkets appear to believe that their countries banks can generate value through cross-border M&A activity, but this belief does not extend to the Spanish and UK stockmarkets.

Due to the sizeable discrepancies in market values between EME banks and international banks, it is abnormal returns to international banks that drive joint returns to the combined bank. Nevertheless, inter-regional differences in joint returns are observed: acquisitions of Asian banks and CEE are considered value generating for combined shareholders. Similarly, value is generated when international banks' increase existing majority holdings in EME targets and deals are privately negotiated. Joint returns are highest for transactions involving acquiring international banks from the US and Europe (over longer window lengths).

The results presented in this chapter suggest stockmarkets are reasonably sophisticated in determining the value generating properties of cross-border bank M&A activity. We observe both similarities and differences in perception between EME and international stockmarkets. This is expected because there are information asymmetries associated with valuing opaque EME bank assets, and uncertainties associated with investing in banks in financial systems that have been under distress in recent times. In a small number of transactions, ownership rights are limited by regulations. Nevertheless, we expect the internationalisation of banking to continue as regulations on foreign ownership of domestic banks are changed. Similarly, increasingly competitive markets in US and Europe may force banks to seek out shareholder value in EME that offer potential for expansion and diversification.

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