

JYVÄSKYLÄN YLIOPISTO
Taloustieteiden tiedekunta

**A CASE STUDY OF THE MOTIVES AND EFFECTS OF THE
UBS AND NORDEA MERGERS**

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Laatija: Susanna Horn

Ohjaaja: Professori Juhani
Raatikainen

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1 INTRODUCTION

1.1 Background and motivation

Mergers and acquisitions (M&As) are influencing markets on several levels: they reorganize organizations, shape industries and even affect entire economies. Considering all these levels of influence, M&As have both micro- as well as macroeconomic effects. Merger activity itself is an important mechanism in the modern financial world, that lets capital flow to areas that need it most, thus enabling markets to be more sufficient.

The current merger activity has basically three unique characteristics (Vaara 2000, 7-8). First, mergers and acquisitions have increasingly involved a combination of companies operating in similar businesses and competing directly with each other. Second, M&As are carried out in larger and larger companies, leading to so called mega-mergers (Kleinert 2000). Third, cross-border mergers have become more popular, especially within the European Union as a part of the European integration process (World Investment Report 2000). The simultaneous deregulation, liberalisation, market integration and financial crises have been in a close interaction with these characteristics of the current merger development.

Even though the volume of M&As has increased strongly during the 1980s and 1990s, there still can not be found specific academic case studies of individual companies and the implications of and strategies behind their M&A activity. This could be rationalized e.g. by the unavailability of proper information or the lack of interest in isolated cases. However, the analysis of the strategies and implications of M&As should be evaluated also from a more narrow perspective in order to find more general applications and theories.

1.2 Research problem

I shall focus my study on analysing the strategies and effects of mergers and acquisitions in the financial services sector. I have formulated the research problem as follows:

What are the reasons behind the UBS and Nordea merger activities and are there any similarities among them?

I am going to limit my research on financial markets. There is an abundance of interesting markets to be investigated but in this study I will restrict my research on the field of financial services. In fact, the main emphasis can be narrowed down even further: the organisations in the case study are primarily characterised by being commercial banks. These organisations have activities also in the insurance sector, however, that is a rather irrelevant function. In addition to that, I am going to limit the extent of impacts of mergers and acquisitions, since the issue is a complex one. There is no single, unambiguous measure to correctly estimate the merger effect on the banks or society, so I have decided to analyse the strategic business activity choices as well as the employment effects of the M&As.

I have chosen two separate financial organisations for the case study of my research, namely the Nordic bank Nordea and the Swiss bank UBS. The reason for this choice is the fact that both are large players in the present financial world, Nordea from a Nordic perspective and UBS from an even larger, world-wide perspective. And, more importantly, both have gone through heavy restructuring in the past few years but still have their unique characteristics. They have enlarged their organisations significantly, even though the enlargement has been carried out with different strategic purposes. Nordea has developed a Nordic banking organisation specialising in the retail banking business within all the Nordic countries, whereas UBS has focussed on the more specific business area of private banking and asset management on a world-wide scale. So, both cases have some similarities as well as differences, which makes the analysis interesting and straightforward.

As, for example Vaara (2000) points out that a majority of academic M&A research has been based on a managerialist perspective. Value creation (e.g. Ravenscraft & Scherer 1989) and abstract synergy calculations (e.g. Larsson 1990) have been carried out in numerous occasions. In addition to that, most studies have focused on examining only one or two theories and hypothesis on a broad set of merger cases, leaving other, possibly important elements aside. This has resulted in fragmented and inconclusive understanding of the M&A phenomena. In this research I try to contribute to an alternative approach to M&As by analysing them from a single company level in unique case studies. Because previous research provides little guidance to a case study of mergers and acquisitions, the approach of this study is somewhat explorative.

1.3 Discussion of the key concepts

A business combination can be classified as either an *acquisition* or a *merger*. *Takeovers* cover both mergers and acquisitions. Mergers and acquisitions are the two primary forms combining two or more businesses. In an acquisition, the acquiring company purchases assets or shares, or in more general the controlling power, of another, and the target firm's shareholders cease to be owners of that firm or they become minority owners. This purchase is usually carried out by a tender offer for the target shares. A tender offer is a cash or stock bid by the acquirer for a block of the target's outstanding common stock. The shareholders accept the offer by tendering their share, and those not tendering retain their ownership claims to the target firm¹ (Shepherd 1990, 193-194). In a *merger*, the shareholders of the combining firms remain as joint owners of the combined entity, in other words, they pool their interests. A merger as well as an acquisition usually constitutes as act of investment but there is a noteworthy difference between pure investment flows and M&A's. A merger is basically an exchange of existing asset whereas investment flows involve the creation of new plant and equipment (Oster 1994, 212).

¹ The bidding process in a tender offer is similar to an open auction where a bidder must outbid all competitors in order to acquire the target.

Besides pure mergers and acquisitions there are also other forms of restructuring transactions between companies. A commonly used transaction is a *divestiture* (selling off) of branches by firms (Greer 1980). This is a way for companies to dispose of weak or otherwise not wanted operations, which are usually loss-making operations not part of their core competencies. There have been a number of cases in the history of many companies, when they have concentrated only on their main activity and therefore disposing other non-relevant activities. Or, on the other hand, there have been quite as many, if not more, cases, where the company wants to expand its operations to reach more markets and therefore purchasing some small branches from other firms.

Altogether, *acquisitions* and *mergers* have both their unique characteristics. Thus it is important not to get confused between these concepts. In theory, the term merger has two meanings in the context of combining organizations. First, it can refer to any kind of contractual combination between companies. The second, and more specific meaning explains merger as a combination of organizations, which are similar in size and which create a new organization where neither one can be considered to have a superior power over the other (Vaara 1999, 7). The previous empirical research and literature, generally speaking, uses interchangeably the terms mergers, acquisitions and takeovers. Therefore, in the first parts of this research, where I give the theoretical background of the area, I do not separate those terms, except naturally in cases, where results may relate to only a certain type of acquisition.

The concept of financial sector should also be clarified at this point. The institutions, services and products that comprise the financial sector vary from country to country. Generally they include: the central bank; depository organizations such as banks, building societies or mortgage banks; credit unions or cooperatives; insurance and pension funds; general financiers; cash management firms; and others engaged in financial intermediation. (International Labour Organization 2001, 5). The financial market is different from most other industries. There is a strong presence of asymmetric information causing adverse selection and moral hazard problems. There exists a number of “insiders” or people having superior knowledge about company performance, market trades and other financial transactions. Usually these insiders

are bound by trade restrictions, but sometimes they are, in pursuit of own wealth, misusing their information and doing business based on the inside information. This naturally leads to market imperfections, which can be quite severe if large sums of money are involved (Vesala 1993, 19-20).

1.4 Structure of the thesis

The remainder of this thesis is organised as follows:

- Chapter 2 reviews various theories about M&As, in particular the forces encouraging and discouraging them and strategies behind them. It also brings and insight to the effects a merger may have regarding e.g. the personnel.
- Chapter 3 discusses the financial atmosphere of the subject countries. It sets up the surroundings of each Nordic country involved in the Nordea case as well as the Swiss surroundings, which are relevant in the UBS-SBC case.
- Chapter 4 consists of the description of both individual cases. The cases are subdivided into three parts: a brief description of the companies and the actual merger procedures; a detailed description of the business unit development (strategic development); and a detailed description of the personnel development.
- Chapter 5 provides the empirical findings of the study. It compares the Nordea case with the UBS case and analyses their differences and similarities on basis of the theoretical framework.
- Chapter 6 presents the summary and conclusions of the research.

1.5 Literature

The literature used in this study consists primarily of domestic and foreign studies, textbooks and journals on mergers and acquisitions, industrial organisation and strategy. Irreplaceable additions to the material have been the numerous articles in newspapers like for instance Financial Times, The Banker and Mergers & Acquisitions. Some of the media houses' web pages have proven to be most helpful

in the task of finding up-to-date information. The reports of large organisations such as the International Labour Organization, the United Nations and several central banks have been a significant source of detailed developmental facts.

The data of the case study is found from several sources. First, the figures in the annual reports have been used. They can be taken as a reliable source of information, since the presently valid accounting policies ensure, that they are correct and objective enough. Second, newspaper articles, clippings and press releases have supplied a large amount of information. Third, the Bloomberg's information service has provided some data about the mergers and their details.

2 REVIEW OF RESEARCH ON MERGERS AND ACQUISITIONS

There exists an abundance of research made on mergers and acquisitions and there has been a growing academic interest in this subject. In addition to that, also investment bankers, analysts, consultants and other researchers from the private sector have shown an interest in these matters. Especially during the last few decades the strategic, human resource and cultural perspectives of M&A's have been a popular subject of research. In this chapter, I will review existing theories and evidence in those areas of M&A literature, that are related to my research problem.

2.1 Background

There are approximately 4 000 mergers and acquisitions taking place every year. The total number of all M&A's worldwide (cross-border and domestic) has grown at 42 % annually between 1980 and 1999 (World Investment Report 2000, 106). This activity is not a recent development and researchers have actually divided the historical advancement into four periods, *merger waves*. These waves took place in the United States, the first one in 1897-1904, the second one in 1916 – 29, the third in 1965 – 69 and the fourth one in 1984 – 89. The current merger wave started in the early 1990s and is still continuing (International Labour Organization 2001, 3; Shepherd 1995, 187), at least until the beginning of this millennium.

Although these merger waves are primarily characterised to have taken place in the US, similar progression has also occurred in Europe². A large increase in merger activity occurred in Europe between the mid-1950s and 1970, especially in the British industrial sector. In the late 1970s the merger activity increased again, and the last

² In Japan the progression has been different, since their business culture has been traditionally against heavy M&A activity

merger waves have been occurring simultaneously with the US merger waves (Oster 1994, 217).

2.2 Types of mergers

The M&A-activity is seen to shape the entire structure of a market, which can be observed from historical data as well as from the structure of present markets. The relevance of the issue lies in the fact whether or not the merging companies act in the same or in different markets. Mergers and acquisitions are of five main kinds³ (Greer 1980, 127-128; Shepherd 1990, 188; Oster 1994, 212) and they will be demonstrated in the following.

- 1) *Horizontal mergers* take place between companies within the same industry. They are typically believed to raise market power, for by definition they eliminate side-by-side competition between the two firms. The economies of scale are in this case the most important value-adding factor.
- 2) *Vertical mergers* on the other hand are characterised by combining two companies acting in the same industry, but in different stages of production operations. Since the production of a good usually involves several stages, it may be seen as productive to implement more than one production stage to the firms business.
- 3) *Concentric, product extension mergers* are carried out between two companies wanting to broaden the product lines because of similar technology or research and development activities.
- 4) *Concentric, market extension mergers* involve companies, which are both engaged in unrelated business activities but they have similar markets,

³ Sometimes, in literature, mergers and acquisitions are divided into only three kinds, instead of five: horizontal, vertical and conglomerate mergers. The concentric acquisitions are not individually emphasized; they are included in the conglomerate mergers.

marketing- and distributing channels or the operations have been conducted in differing geographic areas.

- 5) *Conglomerate mergers* are a more complex matter. They combine two firms, which are acting in completely different markets. These are typically carried out in cases, where companies want to broaden their product lines, in order to minimize the risks they may face by offering just one product.

Each of these acquisition types poses distinctive issues; each may provide greater efficiency, reduce competition and provide a greater market force. On the other hand, acquisitions are widely criticised because of their effects on a company's working climate, the increasing corporate power at the cost of democratic decision making, loss of national control, increasing power imbalance between those who manage and those who are managed, increasing bureaucracy etc. (Vaara 2000, 7).

In practice, many mergers carry elements of some or even all these groups of mergers. If that is the case, then the concerned companies or at least one of them is a diversified company operating in more than one field of business (Hay & Morris 1991, 496).

2.3 Motives for M&A's

There are numerous motives for carrying out a merger in the financial services sector. Motives may vary with firm characteristics such as size or organizational structure, over time, across countries, across industry segments, or even across lines of business within a segment. The main reason is, from an economical point of view and in a world characterised by perfect capital markets, naturally to gain profits and to maximize shareholder value (Ravenscraft & Scherer 1987). However, in the framework used in this study, the motives for mergers and acquisitions are broken down into two basic categories: value-maximising motives and non-value-maximising motives (Berger, Demsetz & Strahan 1999).

Value maximising motives

The value of a financial institution, like any other firm, is determined by the present discounted value of expected future profits. Mergers can increase expected future profits either by reducing expected costs or by increasing expected revenues. So, the value-maximising motives can be divided into two subsections: 1) increasing efficiency (lower costs) and 2) increasing market power (price setting, higher revenues).

The **increasing efficiency factors** are usually characterised by the following factors (BIS, 2001; for more detail Shepherd 1990):

- 1) Economies of scale, which means that larger production units can produce the outputs with a lower price, thus enabling the company to achieve increased profits. Economies of scale arise in the firm's activities, such as production, marketing or innovation by causing the firm's average cost to decline as its size increases. The economies of scale are more difficult to detect in larger and more diversified firms, because they may be limited to certain product lines and do not show up in aggregate, firm-level data. There are also international findings suggesting that there seems to be no evident economies of scale in the banking sector (e.g. Clark 1988; Kjellman & Lindholm 1992; Berger, Hunter & Timme 1993);
- 2) Economies of scope, which leads to reductions in unit costs due to synergies involved in producing multiple products within the same firm. An example to this is a bank, which expands its services to the insurance sector;
- 3) Replacement of inefficient managers with more efficient managers of management techniques;
- 4) Reduction of risk due to geographic or product diversification;
- 5) Reduction of tax obligations since the presently valid tax laws allow companies to pool their profits and losses. This makes it quite obvious, why a profitable firm may acquire a losing firm. After all, they can pool their losses and profits and it is possible, that the new organisation may end up paying no taxes at all.
- 6) Increased monopsony power allowing firms to purchase inputs at lower prices. This may be the conclusion of two different kinds of mergers: either the firm acquires a firm, which is producing the acquirer's inputs or it acquires a firm,

which has already negotiated favourable contracts for purchasing inputs from the producer.

- 7) Allowing a firm to become large enough to gain access to capital markets or to receive a credit rating;
- 8) Providing a way for financial firms to enter new geographic or product markets at a lower cost than that associated with de novo entry.

All of these motives lead consequently to lower costs for the firm. Especially important are the economies of scale and scope, as well as the reduction of risk through geographic or product diversification. These are definitely facts used to rationalise most of the recent mergers and acquisitions to the shareholders⁴, even though the economies of scope might not even be detected.

The **increasing market power factors** lead usually to an increased market power through the ability of the companies to set their prices in a freer way. If the company achieves a very high market power, it may lead to a monopoly situation, where it is able to raise the prices to a level, which would not be possible under perfect market conditions. Companies having market power and profits as a motive usually want to purchase or merge with a company acting in the same industry (Tirole 1988, 194-95). Vertical and conglomerate mergers might have an effect on raising the company's market power, but not necessarily. Horizontal mergers, on the other hand, raise inevitably market power and as a result a higher profitability can be achieved. That is the reason why it is important to be aware of the generally tight competition laws when planning a merger. Each country has its own regulations for a single company's market power and they are strictly observed. Within the EU, the decision-making has been centralised and the EU Commission and the Commissioner for Competition are making the statements and giving approvals or denials for the planned mergers.

The increasing market power factors include (BIS 2001):

- 1) Increased size allowing firms to better serve customers;

⁴ see case UBS and Nordea

- 2) Increased monopoly power allowing firms to raise prices;
- 3) Increased size allowing firms to increase the riskiness of their portfolio;
- 4) Increased size or market share making it easier to attract customers. For instance, the marketing power of a firm may be transferred to assist the counterpart of the merger. If a company has had a very successful marketing campaign, it is possible that the results of the campaign are transferred to other firm as well, even though it has not invested in marketing at all.
- 5) Increased product or geographic diversification expanding the pool of potential customers.

Both of these factors, increasing efficiency and increasing market power, are thus maximising the money benefits a firm can achieve by merging. These benefits are generally known as pecuniary (monetary) economies (Shepherd 1990). So, a firm may, without investing in any other resources, gain larger profits by merging.

The diversification factor appears in the efficiency as well as the market power increase. In fact, it is included in, or at least it is in close interaction with many of the other individual factors. In any case, it is an important theme in the present consolidation wave. Diversification can be either product diversification or geographic diversification. Since diversification is neither horizontal nor vertical, it can be doubted that it affects competition and performance in the market at all. The typical firm tends to diversify to nearby areas, rather than to completely new sectors. The present merger wave and the merger wave in the 1980s have presented an increasing trend of diversification, both in the geographical as well as in the product extension level. Since the diversification motive is so important presently, its effects should be evaluated in more detail. (Greer 1980, 142-47, 386-94; Shepherd 1990, 379-83; Oster 1994, 180-94).

The first positive effect diversification has, is the possibility of transferring technology into the new product line or geographic area. The company diverting its portfolio has usually done research in its previous markets and can thus expand its knowledge with a relatively small amount of work in the new area of activity. A second effect diversification has, is the allocation of capital. As reality has shown us, capital markets seldom work perfectly and by knowing its branches well, the management

may allocate capital better amongst new or undervalued branches than imperfect capital markets could. The means for this are the supply of new competition or the funding of new ventures. The third effect is the pooling of market risks. If the managers have come up with a good portfolio of products or geographical market segments, they are no longer depending on a specific segments market situation. Industry returns across markets can be less correlated than within an economy or field of business (World Investment Report 2000, 144). However, these gains are finite and the possibility of making large profits based on one market segment's extraordinarily strong performance is usually pooled by another segment's weaker performance. The fourth effect is the increase of X-efficiency (managerial efficiency) in the acquired firms. Takeovers, or even takeover threats, are a motive for managers of the target firms to increase their efficiency in order to stay employed, or in the latter case, not to be taken over (Peristiani 1997).

However, there are also some negative effects diversification may enunciate. Cross-subsidizing is one of these effects. A firm may use predatory prices in one segment by sponsoring these price cuts with the profits of another segment. This is usually carried out in a highly compatible environment, where the firm needs to achieve a greater market share. Reciprocal buying is also seen as a negative effect of diversification. It means simply that favours are being exchanged and in more detail, that a company is forced to buy from another firm, just because the other one has purchased something from them. This reduces competition. The reduction of potential competition is also a downside of diversification. If a potential entrant diversifies its portfolio by buying a firm already active in the market, then the potential competition is reduced. This is very difficult to measure, since it is not at all clear, which firms may be new entrants to the market. There are also effects that have to be considered in case there should be only a few conglomerates operating in all of the major sectors. This poses a threat to the local governments, since the managers of the conglomerates have then a big influence in the economical as well as political surroundings. Even though this might seem as a rather extreme situation, Japan and Germany approached such conditions in the first half of the 20th century.

Non-value maximising motives

In addition to the abovementioned, straightforward motives, there exist also other motives, which are non-value maximising. For example, manager's actions and decisions are not always consistent with the maximisation of firm value. Especially, when the managers are not owners of the firm, but rather well-paid professionals, who have their own distinct motives behind their actions. And when the capital markets are imperfect or corporate governance is weak, managers have a better possibility to take actions in order to further their own personal goals, e.g. pursue sheer bigness, gain personal power or financial compensation (World Investment Report 2000, 144). They may engage mergers designed to increase the size of the firm or reduce firm risk, even if such mergers do not enhance firm value. The managerial motives include also cases, where managers are more or less going with the flow, if they do not know better. They may consolidate simply because everybody else in the business is doing so. In case these managerial incentives are not in line with the owner's incentives, it is highly possible that the acquirer faces a risk of overpaying for merger activities (Kjellman & Nordman 2000, 9).

The authorities motives are also characterised by their non-value maximising tendency. Usually, the governmental policies play an important role, especially in larger scale mergers. The authorities may hinder mergers or make them easier, depending on the situation on the market. If the merger involves two large institutions, both facing a financial crisis situation and employing a big number of persons, the authorities may facilitate the merger in order to minimise the social costs of the associated with the firm failure. However, the authorities are also actively hindering some mergers, because of their potentially competition decreasing effect. This occurs in cases, where the involved companies have a large market power to begin with and the merger would increase it to a level, where there would be no more competition.

TABLE 1 Motives behind bank mergers

Value-maximising motives	Non-value maximising motives
1) Increasing efficiency	1) Managerial motives
2) Increasing market power	2) Authorities motives
-price setting and availability	3) Other motives

Source: Berger et al (1999)

Still, there are some mechanisms, which *reduce* the probability of managers to start a merger, based on their own personal, non-value maximising motives (BIS, 2001). The managerial stock ownership is one of these mechanisms. In case the identities of owners and managers do not differ, then their motives do not differ either. Another type of mechanism reducing the managers' incentives to pursue only their own personal motives is a concentrated shareholder ownership. In this case, the actual owners have a better possibility to monitor the managers' actions and this leads to a situation where the managers try to pursue the shareholders' value increase, in order not to get complaints. The presence of independent outsiders on the board of directors is a third mechanism reducing the occurrence of managerial motives. If the shareholder ownership is widely dispersed amongst a variety of owners, then the monitoring of managerial behaviour can be carried out by an independent board member.

Some studies (Allen & Cebenoyan 1991, Subrahmanyam, Rangan & Rothstein 1997) have examined the extent to which these mechanisms work. Even though the studies find evidence, that the mechanisms have reduced the probability of managerial activities to pursue their own well-being, they still show, that some mergers are also carried out on grounds of managerial motives and not value maximisation.

A merger may be carried out on grounds of all the abovementioned motives. A specific merger can provide the concerned firms with a greater market power, it can bring advantages through economies of diversification, scale or scope and bring money benefits by decreasing the amount of taxes. In any given case, more than one motive may underlie the decision to merge. A simultaneous fulfilling of several motives would naturally set an ideal ground for a merger. But, in many transactions this is not the case. They may result only, for instance, in a higher market power and

if the decision-makers of the firm think that this motive is important enough, the merger will be carried out.

However, the actual motives for mergers are usually not directly observable and many may differ from those stated by the management at the time of a merger announcement. Researchers are limited to inferring the motives from observable factors such as the characteristics of firms that merge, the post-merger performance of cost and price measures, the relationship between average cost and firm size etc.

2.4 External forces encouraging consolidation

In addition to the company's own motives for merging with or acquiring another company, there are also external forces influencing the consolidation. A great part of the present structural change and restructure in the financial services sector is caused by the changes in the competitive environment (BIS, 2000). The major factors behind the structural change are:

- 1) Technological advances
- 2) Deregulation
- 3) Globalisation

2.4.1 Technological advances

Technological advances are an important step forward in the development of the financial sector. The recent developments in the technology of the banking environment have enabled great cost savings, especially in the distribution capacity. The faster computing systems and greater privacy in the Internet connections have given financial services providers a possibility to offer a larger scale of products with smaller costs. For example Internet banking, automated teller machines (ATMs) and telephone banking have been able to reduce branch office costs and bring the bank's products over wider geographic areas. Clients are increasingly serviced through automated means without face-to-face contact with bank personnel. (Vesala 2001).

Technological advances have created an entirely new set of financial services and products. Technological advances combined with innovations in financial engineering techniques have enabled financial institutions to develop more efficient and practical products, than what was previously possible. A few years ago, the mere thought of every household having an own computer was incomprehensible and now it is one of the major instruments to take care of the personal banking affairs. Modern technology enables financial institutions also to make rapid adjustments in the characteristics of their investments portfolios, including the risk profiles.

Technological advances in conjunction with deregulation, has enabled financial institutions to broaden their product portfolios also to other sectors, not only traditional banking. On one side, traditional banks have been able to provide new products like for instance in the insurance sector and on the other side new entrants have been able to provide customers a range of banking-type products. The barriers of the financial sector is thus blurring and bringing a whole new set of products for the participants in that sector.

The financial institutions have been increasingly able to find information about their customers because of the technological changes. This is in close connection with broadening the product portfolio. The distinguishing fact here is, that the increased knowledge of the markets and customers have made it possible for the service providers to provide products especially tailored to fulfil the specific needs of targeted customers.

2.4.2 Deregulation

Deregulation of the financial sector has been an especially important trend in the European Union in the 1990s. Until that point, many sectors of industrialised countries⁵ were highly regulated through entry conditions, public ownership, limits on the range of permissible activities and limits on mergers (Neven 1989, 3-5). The

⁵ for example telecommunications, power production, airlines, financial services.

cause for the regulation was most likely the belief, that the concerned sectors were so important for the entire economy, that they should not be let influenced by the free market conditions (Kleinert & Klodt 2000, 48). However, in the late 1970s USA and the UK begun to re-evaluate the level economical efficiency of those regulated sectors and started to deregulate them. The financial sector of most other European countries was not deregulated until recently, since the regulations were seen to enhance consumer safety and prevent bank failures (BIS 2000, 73). The EU commission has had the goal of a common financial market within the European Union and it has wanted to create uniform competitive environments for all the countries in the union by removing national regulations. On the company level this has started a stronger merger activity since they have had to re-orientate to meet the new market conditions (Kleinert 2000,174).

In a closer evaluation of the deregulation there are two specific regulatory liberations, which have constituted to a large part of the environmental changes (Vesala 2001, 26). Firstly, the regulations on banks' competitive conduct have been largely eliminated. These regulations included controls on banks' deposit and lending rates, fees and commissions, as well as direct credit quotas and branching limitations. They have been replaced by indirect standards, such as adequate capital structures, diversification exposures and business practices, and requirements concerning the supply of information about financial services and products. Second, the functional separation of financial institutions was discontinued and financial institutions were given the liberty to offer a broader range of products. This has enabled them to enter new markets thus increasing competition.

It is difficult to disentangle the effects of regulatory reform in financial services from other effects such as technological advance and globalisation. At times regulatory changes have merely ratified changes that had been previously implemented by the market. So, in theory, changes in the legislation may not be a strictly necessary condition for consolidation. Nevertheless, deregulation has increased the flexibility of companies to do tactical moves in the market and enlarged the set of strategic possibilities. In an interview carried out by the members of the G10 Task Force on Causes of Financial Sector Consolidation (BIS 2000) nearly 40 % of the respondents thought that deregulation has been a very important motive for domestic

consolidation in the financial sector. However, when considering cross-border mergers, the figure falls rapidly (see appendix 2).

2.4.3 Globalisation

Globalisation is in many respects a by-product of technological advances and deregulation. Naturally this aspect can be considered also from another angle, that deregulation is a by-product of technological advances and globalisation. In any case, globalisation presents a third relevant cause for the increased merger activity of the 1990s. The central phenomenon of globalisation is the strong increase of foreign direct investments, which are usually in the form of mergers (World Investment Report 2000).

There are two central reasons, why global industries arise: comparative advantage and the existence of economies of scale (Oster 1994, 99). The theory of comparative advantage is, that since some geographical areas have better natural resources to produce a certain good, they should export them, whereas some areas excel in the production of other goods thus exporting them (Krugman 1994). Scale economies on the other hand create advantages of industrial clustering, making it more reasonable to build larger entities to produce a good. However, high transportation costs of the finished product will reduce the extent of globalisation, since the cost advantages of large-scale production will be reduced. The environmental impacts of extensive production facilities and transportation should be taken under consideration also, when building a global reach of industries⁶. These matters are more or less a problem of heavy industry, not necessarily the finance sector. Nevertheless, the financial sector has received some critique also, regarding globalisation. In fact, this is the core idea of the Attac-movement, which has set a goal of removing speculative currency transactions through the "Tobin tax"⁷.

⁶ <http://www.vihrealiitto.fi/lennakit/globalisaatio.html>

⁷ <http://www.attac.kaapeli.fi/doc/julistus/>

The globalisation of the financial sector has affected the shift from the bank-centred system to a market-based one. As capital markets have expanded and become more liquid, the traditional investing into low-interest accounts has turned towards more international commercial papers and bond markets. Customers are able to invest more easily into higher-interest securities. This can be observed on the liabilities side of banks' balance sheets, where there has been a substantial outflow of deposits to a wide range of competing financial products offered by various institutions in different sectors. In response to the increased competitive pressures, some institutions have opted to expand via the merger route to reach a perceived threshold size for scale economies.

Globalisation has affected the financial markets in three ways (International Labour Organisation 2000, 15). First, global capital markets have made it easier for companies to raise capital. Physical size is no longer a precondition for attracting capital and the advantage of size is thus diminished. Second, the removal of geographic barriers have given companies access to more customers, so those companies can build big customer bases even if they focus on just one narrow product. Finally, the digital revolution means that a business can be built on much narrower specialities for several reasons. For instance, banks used to keep the credit card processing in-house, since it was cheaper that way. Now the marginal costs of interacting with other firms are falling, making specialisation more reasonable.

2.5 Forces discouraging consolidation

In addition to forces encouraging consolidation, also the forces *discouraging* consolidation have to be taken into account. The main factors impacting the consolidation wave negatively are:

- 1) Regulatory barriers
- 2) Information failures
- 3) Cost of complexity
- 4) Cultural differences

The local governments as well as the Commission of the European Union have been active in trying to reduce and even remove these forces, even though the removal of some of them, e.g. cultural differences, is more or less impossible.

2.5.1 Regulatory barriers

The regulatory barriers are the most prominent force discouraging consolidation. The legal and regulatory framework of many countries presents for many companies a hindrance for carrying out a merger. The United States has had a much freer environment than Europe, and they have believed more on the free market forces than the higher regulated European economies (Shepherd 1990, 455). In Europe, many governments have taken a role in approving or denying large foreign investments in domestic financial institutions. But, this is not the only way governments can influence the consolidation of some sectors. The governmental ownership in large organisations is not at all rare and by owning a substantial part in an organisation, the government can regulate its activities quite remarkably. This is especially true in the Nordic countries, where the state has a high degree of ownership in the largest financial institutions. In fact, the Swedish state is the largest single shareholder in Nordea, Fenno-Scandia's largest financial institution (Nordea Annual Report 2000).

The competition policies are a part of the legal framework of the financial sector. Some consolidation projects are denied on the grounds that they would create a too large market power for a single actor and lead to market inefficiencies. Presently, within the European Union, the competition laws are executed in two different levels, the national as well as the EU-level governments. The task of these authorities is to enhance the efficiency of the economy by promoting competition and taking measures to abolish competition restrictions and implementing the control of concentrations⁸. Barriers to entry may, however, surface, which usually represent one of three kinds: legal, economic or strategic.

⁸ <http://www.kilpailuvirasto.fi>

Legal barriers refer e.g. to public regulation preventing the entry of new domestic or foreign banking institutions to a new banking market. However, in the common market, banks have been stripped off of most of the legal barriers to the expansion of operations to the other EU countries. For example in Finland, foreign banks face no legal barriers whatsoever to market entry. It should be noted that, over time, regulatory differences across countries can be expected to diminish, tending to reduce barriers to cross-border consolidation. Especially noteworthy for the removal of legal barriers has been the implementation of the “second banking directive”⁹, which introduces the so-called single banking license. It enables any bank to establish branches or subsidiaries or to offer a wide range of services in another EU country.

Economic (or business-related) entry barriers refer to various business difficulties that foreign banks may face in the new market, which may ultimately totally block the transfer therein. In the banking industry, economic barriers may include high investment costs and the absence of economies-of-scale or economies-of-scope. The high investment costs are also expected to decrease as a consequence of technical advances.

The competition authorities, however, have focused their energies on strategic entry barriers caused by the activities of the banks already operating in the markets. Today, the strategic barriers are increasingly related to different electronic banking services provided through various kinds of electronic banking networks.

2.5.2 Information failures

Information failures within the concerned companies hinder the implementation of a successful bank merger. The fact, that there may not be uniform accountancy principles or asset valuations, leads to a poor comparability of the companies. The existence of information asymmetries among standards across sectors and countries could be removed within the EU-countries and internationally through e.g. the

⁹ Directive 89/646/EEC of 15/12/1989 - EC Official Journal N.386 of 30/12/1989

implementation of the international INTOSAI auditing standards¹⁰. There still remains the problem of the lack of transparency, which is controlled by each company individually. The lack of transparency may result in a more risk avert behaviour of shareholders, since they do not have a complete knowledge of, for instance, hidden costs of the transaction.

2.5.3 Cost of complexity

The costs of managing a large and heterogeneous institution can be substantial. First of all, the integration process itself can lead to large costs within the organization. Even a complex organization operating in various fields of business has to be organized in a manner that it can be easily managed. For example, a strategy of combining businesses with highly volatile earnings such as investment banking with more stable performers such as private banking might lead to a loss in focus as well as weaken the specific strengths of the constituents. Nevertheless, this may also lead to a better risk portfolio, depending on the capabilities of the managers.

2.5.4 Cultural differences

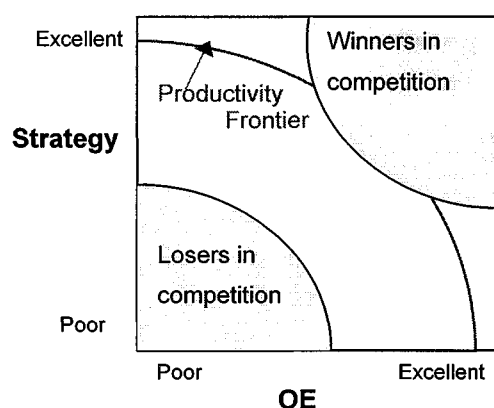
Cultural differences are one additional force to discourage consolidation and a barrier to enter new markets. When a company has a strategic choice to enter a market in a completely different cultural environment, it has to weigh the implications of cultural blending thoroughly. These cultural problems may arise on all levels of a corporation, on the managerial level as well as on the basic employee level. These problems are quite different than regulatory barriers; they are not simply removable. They are also often underestimated amongst the decision-makers, even though they are a substantial part of the integration process after a merger. Especially in the case of cross-border mergers it is important to research the cultural fit of the transaction. But there are also cultural differences between corporate level cultures, as was seen in the KOP-UBF merger (Tienari 1996; Heikkilä 1998).

¹⁰ http://www.eca.eu.int/EN/audit_methodology.htm

2.6 Strategies and operational effectiveness

Mergers and acquisitions are often carried out to serve a company's strategic visions. However, they may also serve to increase the operational effectiveness of the firm. The distinction of these two concepts, strategy and operational effectiveness, is important for the success of the company, since they work in different ways (Porter 1996, 61). Nevertheless, both of them are essential for a good and sustainable business performance (see figure 1).

FIGURE 1 Ideal business performance¹¹



Operational efficiency (OE) is primarily characterized by supplying similar products or services than the competitors but in a better way, or, more concretely, producing more outputs with lesser inputs or costs. A central theme in the concept of OE is the above mentioned productivity frontier (Figure 1) that constitutes the sum of all existing best practices at any given time. In practice, all companies move to the upper right, when increasing their OE. OE is usually increased by eliminating wasted effort, employing more advanced technology, motivate employees better etc. In general it might be considered, that OE is a technical efficiency, which directly affects the relative cost position of the respective company. As new technologies and management approaches are developed, the productivity frontier moves outward. If we consider mergers and acquisitions in this context, then the companies merge or

¹¹ <http://www.worldbank.org/html/extdr/offrep/eap/eapprem/plenaryapresfairbanks.pdf>

acquire in order to lessen their production costs, or in the financial sector e.g. branch network costs.

When considering the **strategy** of a company, the key factor is differentiation (Oster 1994, 4). "The essence of strategy is choosing to perform activities differently than rivals do" (Porter 1996, 64). In general, strategic positions emerge from three sources.

- 1) A strategic position can be achieved by choosing a distinct line of products or services. In the financial services sector this includes for instance a company specializing only in providing an array of common stock, bond, and money market funds that offer predictable performance and low risks. Or, on the other hand, a financial company may be specializing in high-risk investments with potentially higher returns. In any case, this kind of *variety-based positioning* can serve a wide set of customers, but for most it will meet only a subset of their needs.
- 2) A strategic positioning can be achieved by targeting a particular segment of customers, a *need-based positioning*. In this case, the company chooses a target group of customers and aims to serve all of their needs in the chosen area of business. In the financial sector this might be for instance the business of retail banking or private banking. The specialization may go even further, for instance private banking services for customers with assets worth more than EUR 5 million. In any case, this enables a better and more personalized service.
- 3) A strategic position can arise from an *access-based positioning*. In this case the company segments the customers by geographic areas or customers, which are otherwise accessible in different ways. A common new access-based positioning in the financial sector is the customer's access to the Internet. Especially in the Nordic countries most households take care of their routine banking business via the Internet, enabling a completely new strategic positioning for the local banks.

When planning a compatible strategy, there are some essential factors that have to be taken under consideration. First of all, a sustainable strategic position requires *trade-offs*¹², which are pervasive in competition and essential in strategy. They create the need for choice and purposefully limit what a company offers. These trade-offs usually arise for three reasons.

The first reason is, that there are some kinds of inconsistencies in image or reputation. In case a company is known for producing cheap and inferior products or services. According to the new strategy they start delivering high-quality outputs, which may be difficult to sell under the same company name. Efforts to create a new image typically cost a lot, especially in financial services sector, where a good reputation and name is a precondition to stay in business. This may even work as a barrier to enter the market or at least imitate the rivals. Second, trade-offs can arise because of the activities themselves. There are differing requirements in equipment, personnel skills or geographic locations for different products. And third, organizational priorities set the boundaries for product portfolios. The management chooses to compete in one way and not another, and by doing this choice it will have a clear strategic position. (Porter 1996, 68-69).

Another essential factor, that has to be considered during the strategy-planning phase, is achieving a perfect combination of activities, a *strategic fit*. A fit is important for the company, since all of the company's different activities are in interaction. Usually this is also the key factor in mergers and acquisitions. Investment bankers are looking for a fit amongst target companies and after having found one, they sell the idea the further to the managers of the concerned companies. In most cases, a fit consists of a simple consistency between each activity. For example, this consistency may be a low-cost strategy, which is then applied to all the company's activities. Another fit is, when different activities are reinforcing. This means, that the selling of one product makes the promotion of another product easier.

However, managers are often over-emphasizing the core competencies and key success factors instead of an overall fit between all activities of the companies.

¹² Trade-off means that more of one thing necessitates less of another.

During times of receding trade, managers may dispose of weak operations, which are making loss and are not part of their core competencies. Still, if the fit has been good in the beginning, and the managers sell some part of the company simply because it is not doing well at that point of time, they may end up in an even worse situation, because they are not considering the effects it has on the other activities. That is why a strategic fit has a great effect on the sustainability of the business. It is harder for a rival to match an array of interlocked activities than merely to imitate one product feature. If there is no fit among activities, there is no distinctive strategy and little sustainability. (Milgrom & Roberts 1995, 179-208).

Even though a company may have recognized the need of a ground-giving strategy, there are some factors, which often lead to an unsuccessful choice of strategy. The most common ones are usually herd behaviour or lack of vision among the managers and decision makers of the companies. Herd behaviour means that the concerned companies choose to imitate everything about their competitors, even though it would not fit their own line of business. Simply because a rival has been successful with one kind of strategy, it does not mean that everybody will. Lack of vision basically means the same; the managers do not have a clear enough vision of their strategy, thus being unable to do good strategic decisions.

The pure desire to grow is also a topical reason, why strategies go wrong. Many managers have a general desire to build a large company simply because they believe that size compensates for a lack of a functioning strategy. Compromises and inconsistencies in the pursuit of growth will erode the competitive advantage a company may have had with its original varieties of target customers. An attempt to compete in several ways at once creates confusion and undermines organizational motivation and focus. Often rivals continue to match each other until desperation breaks the cycle, resulting in a merger or even downsizing to the original positioning. At that point it is important to understand the value of a specific strategy instead of having just growth as the trend-setting strategy.

On the other hand, the present trend of globalisation allows a company to grow and still stay persistent to its original strategy (Porter 1996, 77). In expanding globally, the field of business stays the same, but the geographical area grows. The critical point

is, that the company still has a superior knowledge about the new market areas, and therefore it is important to have experts and even stand-alone units working in the new areas. In general, this kind of strategic growth means, that the companies are concentrating on deepening a strategic position rather than broadening and compromising it.

2.7 Impact on working and employment conditions

The consolidation is raising important public policy concerns, notably with respect to employment. Indeed, the announcement of a merger is usually accompanied by an announcement of cost cutting redundancies in the merging organisations. To gain full merger benefits, two overlapping organisations are compressed into one, eliminating duplicated operations, which may lead to redundancies at all levels. It is nevertheless difficult to disentangle the employment effects of M&A's of other factors such as increased competitive pressures, automation, the introduction of new information and communication structures or even overall market changes, which all may occur in the absence of a merger. (International Labour Organization, 2001).

There has so far been little systematic tracking of direct job losses resulting from M&As. There are three distorting factors, why the examination of the employment impact is difficult and the results may be invalid. Firstly, companies often recruit new staff with the skills to suit jobs in new business lines at the same time as eliminating existing positions. Secondly, the companies may realize that their plans were over-ambitious and that the retrenchment programme could jeopardize the company's business activities. Thirdly, regulatory constraints may induce organisations to adjust their initial plans. However, virtually all the worldwide M&A activity has generated lay-offs or employment contraction in financial services. A study by Rhoades (1998) on the efficiency effects of bank mergers in the US, which summarizes nine case studies, reported that all nine mergers resulted in significant cost cuttings, mainly through staff reductions. Payroll reductions often accounted for over 50 % of the total cost reduction and in at least one case the reduction accounted for nearly two-thirds of the total. In Western Europe sectoral specialists predict the disappearance of

approximately 300 000 banking jobs between 1990 and 2002 as a result of continuing sectoral concentration due to M&As.

In addition to the quantitative effects of M&As, they have a substantial impact on the concerned firm's working conditions, which, on the other hand, have a direct impact on the firm's profit-making ability. Since the financial services sector is an industry where know-how and professionalism play a major role in acquiring good customers (Boxberg 2001) and thus making profit, the firm should invest some effort in the well-being and motivation of the workers. This issue has been researched in social studies papers, even in some business studies of specific cases of mergers and their implications in the personnel, but relatively few studies go beyond that and examine broader societal implications.

When a company is merging, acquired or taken over, the personnel of the company faces a difficult situation. They are no longer working for the same company, instead they are working for a new company or for a company that has acquired them. Thus their work contracts are not necessarily valid anymore and they may be discharged. (Heikkilä 1998, 13). M&As have sometimes been described as a legitimate means for breaking for breaking implicit contracts in order to restructure. Basically the employees do not have any power upon these decisions, that are made by the managers and shareholders and in this case, even a long-term work contract does not ease the personnel's situation. The harmonization of the employment structure of the merging companies includes restructurings in pay scales, job titles, entitlements and other benefits, job descriptions, reporting and supervisory lines, in order to ensure common practice in the newly combined organization.

One thing, that the worker is sometimes faced with in company restructurings, is the increasing use of non-standard forms of employments. These are usually part-time or temporary employments and they put the employees in a state of insecurity. These forms of employments are increasing world-wide, especially during times of receding trade. In particular women have been facing this kind of development: over 50 % of women are in non-standard form of employment, whereas the corresponding figure for men is only 10 %. The reasons for the increased use of non-standard forms of employment are first the possibility of reducing fixed costs arising from collective

agreements and strict labour legislations, since many of the regulations do not cover non-standard employment relations. Second, the external labour markets are more competitive, giving the company the possibility to use cheaper manpower. The third reason is the flexibility non-standard employment market gives.

M&As are considered to be factors of stress and de-motivation based on the close relationship between company restructurings and mass lay-offs. The job-security is not as certain anymore and employees may face an increased competition about the job titles left in the new organisation. The element of unpredictability is introduced, creating feelings of loss of control and unfairness. These feelings are in close association with general stress, demoralization, depression and even burnout, which on the other hand lead to decreased productivity. Given that successful management of the restructuring process is vital for achieving organizational objectives, managers need to be aware that downsizing is more than a reduction in headcount and work reorganization. Common understandings, values and beliefs should be built into the merged firms as means of reducing staff dissatisfaction (Tienari 1996).

3 MERGERS AND ACQUISITIONS IN THE SUBJECT COUNTRIES

As I already noted in the second chapter of my paper, mergers and acquisitions are not only happening in a national level, they are a truly global phenomenon. They affect the international atmosphere of the world. Globalisation, which is a commonly used phrase in the current economic discussion, is characteristic for the economic activity of modern companies. Observers believe that cross-border M&As in the financial sector will be the next phase once internal consolidation is complete. In fact, top economical trend-setters, such as Jacques Attali (former President of the European Bank for Reconstruction and Development), Karel van Miert (former EU Commissioner for Competition) as well as David Komansky (CEO of Merrill Lynch) have said, that within a few decades there will be only a very small number of global actors in each sector, including the financial sector (International Labour Organization 2001, p. 5).

On the other hand, for example studies made by Resende (1999), Kleinert & Klodt (2000), and Kleinert (2001) have investigated, that the current mergers are only a part of a merger wave. This is based on historical data, which excludes the possibility of a “random walk” and supports a wave-behaviour.

In any case, the European financial markets have faced a wave of deregulation in the 1980's, because a financial integration and encouraging competition in banking has been one of the main goals set by the European Union. In fact the “home country doctrine” of the EU allows a bank registered in any European country to open branches and offer financial services in any other member country. The doctrine is expected to increase competition and therefore reduce profit margins and improve the performance of the banking industry. In the following I will illustrate the frames of the financial sector of each country in more detail.

3.1 Nordic countries

The importance of banking differs tremendously from one country to another. However, the general trend of the financial services sectors in Finland, Sweden, Norway and Denmark is exceedingly similar. Consolidation is definitely the trend of the financial sector of Nordic countries as can be seen in Table 3. Especially in Sweden the decrease has been tremendous, nearly 80 % of the banks have been shut down, merged with or acquired by larger organisations within 13 years. The total decline of all banks in all of the Nordic countries shows an overwhelming figure of 55 %. Surprisingly, the CEO of Danske Bank, Peter Staarup, believes that financial institutions, especially banks, have reached a point, where no further consolidations are needed (Helsingin Sanomat, 16.10.2001¹³). According to him, cross-border mergers within the Nordic countries are senseless, based firstly on the differing market situations, target groups and products of each country and secondly on the fact that there is simply no more need for new mergers. When the market shares of one particular financial institution rises above 50 %, the competition decreases rapidly and customer relations suffer.

TABLE 3 Number of banks in Nordic countries, 1985 and 1998

Country	1985	1998	Decrease in %
Finland	657	359	- 45 %
Denmark	166	105	- 37 %
Norway	150	100	- 33 %
Sweden	543	121	- 78 %
Total	1513	685	- 55 %

Source: H.Koskenkylä: Threats and opportunities for today's European banks (Bank of Finland, 2000)

¹³ <http://www.helsinginsanomat.fi/arkisto/juttu.asp?id=20011016TA13>

3.1.1 Finland

The banks have traditionally dominated the financial markets in Finland and the Finnish financial markets have been characterised as being highly bureaucratic. In the post-war era the market was hierarchical and formal and the decision-making authority was highly centralized. Thus the liberalization of financial markets¹⁴, which meant that various institutional barriers and protective regulations were removed, created a new set of problems for the Finnish banks. First, the liberalization created a more market-oriented way of banking in Finland. Second, the internationalisation of the finance sector created a rapidly changing, dynamic and a more open climate for the finance sector of the country (Kjellman 1994). The transition phase of the Finnish financial institutions did not run as smoothly as was planned and the entire banking system was greatly affected by credit and guarantee losses in the early 1990's. During this period of time, Finland lived through a difficult depression and banking crisis, based on the fact that the banks had not been able to correctly price nor assess the credit risks. This crisis was regarded as the worst banking crisis in an OECD economy and especially liquidity was identified as an ever-present question of concern. The structural features suggest the existence of competitive imperfections in the Finnish banking market and in the financial market in general (Vesala 1995, 25).

The consolidation process of the 90's can be divided into two steps: 1) the crisis mergers, which took place between 1990-1995 (during the Finnish recession) and 2) the consolidation mergers in 1995 – 2001. The crisis mergers are characterised to have happened purely because of survival pressure. The financial crisis had decreased the profitability of the Finnish banks to a point, where they faced a severe problem, namely the possibility of bankruptcy. (Kjellman & Nordman 2000, 27).

¹⁴ The first wave of financial liberalization started in the second half of the 1970's, by dividing the financial market in "official" segment subject to rate control and an unregulated segment, an expanding short-term lending market between firms. The second wave started in the early 1980's by the Bank of Finland's dismantling of average rate controls. Also foreign banks were now permitted to operate in Finland. The third wave in 1986 abolished the regulation of deposit banks' average lending rates as well as the ceiling on credit interests.

Generally speaking, they had a choice of two possibilities: either to merge or declare bankruptcy. The natural outcome of these possibilities the managers and decision-makers of the banks faced, was that the concentration level started to increase. The consolidation mergers, on the other hand, occurred in an economic upswing and they are generally characterised by a desire to build a trans-Nordic financial market. Cross-border mergers were a substantial part of the then M&A activity in Finland, which was unique in the European as well as the worldwide trend. Even though the total number of mergers had declined, the value of the transactions was still enormous.

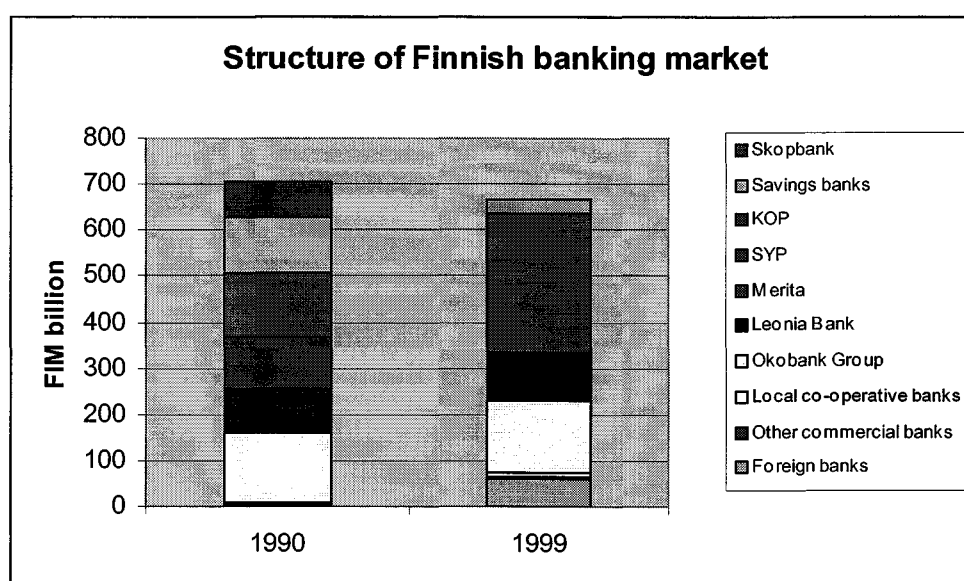
In Finland the number of credit institutions declined by over a third between 1989 and 1995 and the branch network shrank from 3 500 branch offices to 1 950, with employment figures falling from 53 000 to 31 200. By the mid-90's, there were only three credit institutions, which dominated 92,5 % of Finland's deposit and loan markets. These were the three banks MeritaBank, Okobank and Postipankki. From these facts it is easy to notice, that Finland has experienced the largest organisational change ever during the last decade. The level of industrial concentration suggests that the dominance of these three banks has lead to significantly imperfect competition. However, even though the number of players has reduced, the financial markets can be seen to face an increasing level of competition, which is due to the technological development. Especially the fact that Internet and telephone banking has become so common in Finland, has lead to a lasting increase of competition. This is mainly based on the fact that the importance of traditional competition advantages, such as number of branch offices and other labour-intensive services, is reduced (Kjellman & Björndahl 1999, 15; Vesala 2001).

An interesting fact in the Finnish financial markets has been the dominant role of the authorities. This makes the issue of examining the financial markets somewhat more complex. The authorities have been involved in all of the four largest bank mergers in the merger wave of the banking industry in the 1990's. The economic recession in Finland made it clear that the macroeconomic issues were a crucial determinant contributing to the merger wave. The authorities' involvement in M&A's has usually three purposes: 1) regulation of banks (preventing them to become too big – antitrust policies, creating a sound legal base), 2) prevention of financial failures, 3)

government ownership. However, the authorities' involvement in the financial markets has been decreased, aiming towards a freer environment within the European Union.

Foreign and international banks have strengthened their positions in Finland within the last few years. The establishment of representative offices and subsidiaries in Finland was permitted for foreign banks in 1979, but foreign banks were not allowed to open branches in Finland earlier than in 1991. Especially wholesale and corporate banking were the first major activities of foreign banks. Presently investment banking, investment funds, asset management and Internet banking have been popular activities amongst foreign financial institutions and it has increased the competition in those sectors.

FIGURE 2 Finnish banking market measured by market shares (Kjellman & Nordman



2000, 39)

3.1.2 Sweden

In Sweden, banking and insurance have traditionally remained separate, similarly to Finland. In the late 1970s, the banking industry included commercial banks, savings banks and cooperative banks. The structure of the Swedish financial business is

characterised by few large firms, mainly commercial banks, and a relatively small number of small and medium-sized businesses, which were the self-owned savings banks operating in a well-defined geographical area¹⁵. The deregulation of the Swedish financial markets in the 1980's was a big turning point in the history of the financial sector's activity and it had profound impacts on the financial sector's activity. Especially the banks had to adjust to the new, more competitive surroundings and they started the adaptation process by merging and restructuring the companies.

Sweden, similarly to Finland, experienced a difficult loan loss crisis in the banking sector in the beginning of the 1990's and as a result of that, the Swedish banking market became highly concentrated. The main factors, which drove the consolidation, were the "sluggish market growth, increasing competition and the expected effects of European economic and monetary union" (Brown-Humes 1997). The Swedish legal setting was also changed to encourage further consolidation, by permitting companies to own shares in each other and be part of the same holding company.

Cross-industry consolidation was further encouraged in the mid-1990s with legislation that opened the pension savings market to banks and other financial companies. Again, these changes had a large effect on the structure of the banking industry. About 10 of the larger savings banks transformed into one banking group and the 12 central cooperative banks were merged and subsequently transformed into a single commercial bank. Finally, there were only two private banks (Handelsbanken and Skandinaviska Enskilda Banken) and two state-owned banks (Nordbanken and Gota Bank), which dominated 85 – 90 % of the market. In fact, as can be seen from Table 3, the number of Swedish banks decreased by 78 % within 13 years. However, the consolidation would not have been possible if the banks had not fully regained their financial strength after the loan loss crisis in the early 1990s. The return on equity of nearly all Swedish banks had achieved a level of more than 20 % (Brown-Humes 1997).

¹⁵ www.bis.org/publ/gten05.pdf

The larger players in the Swedish financial markets were patient with their deals and waited until 1997, when Nordbanken merged with the Finnish Merita Bank and Stadshypotek AB with Svenska Handelsbanken. Sparbanken Sverige AB merged with Föreningsbanken AB and they became the new FöreningsSparbanken AB, the second largest banking group right after Handelsbanken, measured by asset value. Föreningsbanken Kredit AB joined forces with AB SPINTAB and den Danske Bank acquired Östgöta Enskilda Bank AB. These were huge transactions and transformed the Swedish financial sector to the present setting of a small number of powerful financial institutions.¹⁶

3.1.3 Norway

Norway's unique setting in the Northern financial markets has been its great dependence of the oil industry. Nevertheless, the merger activity has been quite similar to the other Northern countries. The same development of the financial market, as was in Sweden and Finland, can be observed also there. However, the fashion has expressed itself in tie-ups between banks and insurers to form bancassurance giants.

The basic trends in the Norwegian financial sector are almost ridiculously unanimous with the trends seen in Sweden and Finland. Since the beginning of the 1980s the Norwegian financial market has undergone profound changes. The development has been characterised by deregulation, freer regulatory framework, and a strong growth followed by great losses and crises in the financial system. There have been great structural changes in different kinds of institutions within the financial community, which to a greater degree compete about the same customers. This reflects the excess capacity of the financial services sector since there are simply too many branches and too many service providers chasing too few customers. The financial markets are being consolidated and also internationalised. The number of banks in Norwegian financial sector decreased during 1985 – 1998 from 150 to 100 banks, presenting a decrease of 33 %.

¹⁶ www.riksbank.se

The Norwegian state owns shares in the major Norwegian commercial banks, Den norske Bank (DnB) and Kredittkassen. The background for this ownership is the bank crisis in the beginning of the 1990's, which was met by measures by the government to ensure continued confidence in the financial system. In a situation where no private investors were willing to invest, it was necessary that the state contributed with capital. The governmental ownership contributes to commercial management of the banks, and to a profitable return on the governmental and private investments. This governmental ownership has actually become a problem in the last few merger and acquisition attempts and has made a reconsideration of the system necessary.

By 1999 the following large M&A events had taken place: Den Danske Bank acquired Fokus Bank, Handelsbanken of Sweden has extended a bid for Bergensbanken, Swedish Föreningssparbanken took over 25 per cent of the Sparebank 1 Group, Storebrand Skade (non-life insurance) was sold to a newly established Swedish company, and by that time, both MeritaNordbanken and Handelsbanken had stated their intention to bid for Christiania Bank. The most comprehensive changes ever in the competitive situation in the Norwegian financial services sector have been taking place in the near past. International competitors of a completely different size want to take over, with a cost of equity in some cases considerably lower than for Norwegian banks.

The debate on the future of the Norwegian financial services industry and the governmental ownership of financial institutions is an important issue in Norway today. Political parties and the authorities have initiated discussions about the current situation in the financial services sector and what kind of standing point they should have on the restructure of the entire sector. This debate was initially started by the sale of Christiania Bank to MeritaNordbanken since it is seen to have significant consequences on the financial market. These upheavals have enhanced the need for an adjustment of the statutory framework of the financial community through legislation and regulations and a new legal framework has been established by the Norwegian Ministry of Finance.

3.1.4 Denmark

Denmark is not much different from its Northern neighbours. In the beginning of the 1990s Denmark experienced the previous large consolidation wave. Six banks were combined to create Den Danske Bank and Unibank, Denmark's two largest financial services groups. In fact, both of these groups have created an effective market duopoly, dominating the Danish financial services sector. These large mergers were symptoms of a crisis-hit sector, similarly to the simultaneous merger wave occurring in the other Northern countries, where the mergers represented efforts to rescue the banks from bankruptcy. In the turn of the century Denmark has been facing another merger wave, even though the reason for this cannot be found in a crisis, rather in the global consolidation boom. Larger banks have sought an increased share of the market¹⁷.

The trend distinguishing the Danish financial markets from other Northern markets is the stronger cross-shareholding and other forms of partnership between banks and insurance companies (International Labour Organisation 2001, 21). Danish banks have been exploiting their strong balance sheets to buy up smaller rivals also in neighbouring industries such as insurance as well as asset management (e.g. Unidanmark's merger with Tryg-Baltica, Realkredit Danmark's merger with BG Bank, Den Danske Bank's takeover of Fokus Bank).

This kind of activity has given the financial services industry an hourglass profile. Denmark, like the other Nordic banks, has a super-league of large banks offering a broad range of products. But there are almost no medium-size institutions between those big lenders and the hundred or so small regional banks. Another difference between the Danish and the other Northern countries is its geographical location. Its closer to Middle-European markets, which makes the Danish market more attractive to German and Dutch bankers (MacCarthy, 2001) and thus more open to international influences.

¹⁷ <http://specials.ft.com/ln/ftsurveys/industry/sc446a.htm>

3.2 Switzerland

The Swiss financial markets have traditionally been a unique setting within the European markets (Swiss Sectoral Trends 2001, 32). In Switzerland, like in the Nordic countries, the banks have dominated the financial sector although the insurers are becoming increasingly integrated into the more comprehensive financial services market. The authorities have created a beneficial position for both domestic and international financial activity. The advantageous position of the Swiss financial institutions rests on several factors. Swiss banks have had extraordinarily good market positions in all categories of the banking activities, such as private banking, credits, investment banking etc. There are presumably three reasons for this: its high quality of service, the superior level of the bankers' know-how and last but not least the preconditions of the financial sector, including the political security as a traditionally neutral country, the safe-haven status of the Swiss franc and the banking secrecy.

Switzerland is one of the most over-banked countries in the world with 2000 inhabitants per branch. Thus, considering the country's modest size, the financial institutions face a limited set of strategic options.

Until a few years ago the finance sector operated within fairly fixed boundaries, but presently these boundaries are disappearing (Swiss Economic Analysis 2001). Nowadays the competition between banks on a national and international level has become fiercer and that is why the Swiss financial institutions are confronted with the problem of trying to preserve the advantages they have over international competitors. This has made Swiss banks active in merging and created larger and more competitive organisations. However, another reason for the consolidation wave has also been the asset deflation in the real estate market followed by a prolonged period of stagnation in the Swiss economy.

The restructuring had characterised most of the 1990s and reduced the number of banks by about one quarter through mergers and takeovers. During the 1990's there was a sharp drop in banking sector employment in Switzerland and it can be

speculated that this has been caused by the rapidly increasing number of mergers and acquisitions. But, presently this development is possibly changing. A total of 372 banks were subject to banking supervision at the start of 2000, four fewer than a year before and it can be assumed that the merger wave has slowed down, at least for the time being.

At the start of 2000 the banking sector employed just under 108 000 persons in Switzerland and the insurance sector about 47 000 persons. At least medium-sized banks and the Raiffeisen banks featured strong increases in personnel and it remains to be seen, how the sector continues to develop in that perspective. On the other hand, the branch network continues to thin out, though with 2 873 branches (7% fewer within the year 2000) it still seems relatively dense.

The interesting thing about the Swiss insurance sector is, that even though the insurance companies have been actively merging and acquiring, the number of insurance companies has been increasing rather than declining in the year 2000. The reason for this is mainly because there have been so many new entries to the Swiss market, also from abroad. Despite the upbeat growth outlook, the domestic market for Swiss insurers is much less significant than the foreign one, given the formers limited size and high market penetration (in 1999 Switzerland accounted for 38%, EU for 41% and other foreign countries for 21% of the premium income of the insurance sector). Obviously the insurance sector is expanding quite remarkably.

The Swiss banking and, to a lesser degree, insurance industries are characterised by a two-tier structure. The first tier is internationally oriented and consists of two large banks, two large insurance companies and some smaller private banks and insurance groups that focus either on private banking or life insurance, including asset management. The second tier consists of a large, heterogeneous group of small, domestically focused banks and insurance companies. This group includes cantonal banks (state-owned), regional banks, Raiffeisen banks¹⁸ and, in another category with a clear focus on a foreign client base, foreign banks.

¹⁸ aka credit cooperatives

The globally-oriented category of big banks in Switzerland includes UBS Financial Services Group and the banking part of the Credit Suisse bancassurance group. Both have largely consolidated the mergers and restructurings of the last few years (late 1990's until the present). In addition major acquisitions in the US market were carried out, albeit with different emphases. Examples for these are for instance the merger of the Union Bank of Switzerland (UBS) and the Swiss Bank Corporation (SBC) in 1998 and their acquisition of with PaineWebber in 2000. Credit Suisse on the other hand merged with the Winterthur Group in 1997. It is obvious that it will be difficult, if not impossible, to maintain this kind of growth rate, but the Swiss bankers see it as a solid ground for further, if slower, improvements in earnings. The pressure on the profit margins will be hard, since the cantonal banks are expected to gain market shares through their modernization and privatisation plans.

4 CASE STUDY

I have chosen two mergers between large financial institutions for the empirical part of my research. The first one occurred in 1997 between two Swiss banks, the Union Bank of Switzerland (UBS) and the Swiss Bank Corporation (SBC). The second case is somewhat more complex and it consists of a chain of three actual mergers and one takeover, which started in 1995. The involved banks in the latter case were the Finnish banks Union Bank of Finland (UBF) and Kansallis-Osake-Pankki (KOP), the Swedish bank Nordbanken, the Norwegian bank Christiania and the Danish bank Unidanmark.

The reason for this choice is that Nordea and UBS are large players in the present financial world. The recent restructuring has been intense in both companies. Nordea has had the aim of building a Nordic banking giant, especially in the field of retail banking and UBS has focussed specifically in private banking and asset management. The recent merger activity has in fact underlined these strategies. However, there still remains the question, whether or not the strategies of both companies are actually alike, just that Nordea is in an earlier stage of development.

The merger of UBS and SBC has been carried out from a different standing point than what was the case in Nordea, since the position of UBS and SBC is a truly international one and they have a global geographical market area, facing the more or less realistic possibility to become world-leaders in financial services. In contrast to that, Merita and the other Nordic banks are facing a much smaller market in the Northern region. This is what makes both of the cases unique and therefore interesting.

There have been several studies (see, for example, Morck, Schleifer & Vishny 1990; Jaakonsaari 1998; Cybo-Ottone & Murgia 2000; Ghosh & Lee 2000; Alanen 2001), each evaluating the effect of acquisitions on the share price and shareholder value with statistical tools (event studies). They have used a broad database with

numerous cases. Since there is a high degree of simplification in these event studies, I have decided to analyse two separate cases and their particular details, in order to find accurate motives for these mergers. No two mergers are alike and that is why, in my opinion, it is just as important to research the unique cases than entire industries or industry segments.

In order to get a detailed picture of all the implications of these mergers, a great number of factors would have to be analysed, e.g. the company's market value (Jaakonsaari 1998), risk diversification (Chkir & Cosset 1999), short- or long-term profitability (Polasky & Mason, 1998), efficiency (Peristiani 1997), market structure (Cetorelli & Gambera 2001). In the extent of this research it would be impossible to do this, so I have narrowed down the research to two different perspectives.

The one interesting perspective of a merger, in my opinion, is the effect it has on the business structure of a company. It may be, that as a consequence of a merger the strategy of a company is changed and it is focussing on different key products than before (Vaara, 1999, 7). I have tried to analyse this development through a business area analysis. The second focus of my case study is the effect a merger has on the personnel, from a quantitative point of view. Since both of them have objective measures, such as for instance the number of employees, the structure of business areas etc., I would say that the results should be quite reliable.

4.1 UBS and SBC

The merger between two of the largest banks in Switzerland has created one of largest and most powerful financial houses in the world. Both the Union Bank of Switzerland (UBS) as well as the Swiss Bank Corporation (SBC) is a product of over 125 years' banking heritage in Switzerland.

The history of UBS has been distinguished by many important mergers, it itself was created in 1912 by the merger of two major regional banks, further substantial takeovers occurred in 1945, 1967, 1985 (numerous smaller acquisitions had

occurred throughout the history of the bank) and that way it has been able to build a comprehensive field of business. The history of SBC is also characterised by M&A-activity, it too was a result of a merger in 1896, and further restructuring was carried out nearly as often as in UBS¹⁹.

The background leading to the merger between UBS and SBC was the consolidation and the structural changes of the financial sector worldwide (Warner 1997). The number of financial institutions had declined in Switzerland (as well as world-wide) and this merger was characteristic to the then development of the financial sector. Switzerland is a significant player in the global financial markets and therefore it has to adjust to the changes in the international atmosphere. Another important fact about the financial markets of that time, besides the restructuring wave was, that the international markets were confronted with turbulence from Asia and this partly led to a weaker result also for UBS and SBC and to a situation where something had to be done. (Swiss Sectoral Trends, 2001; Swiss Economic Analysis: UBS Outlook, 2001).

During the preliminary phases of planning the merger, the Group Executive Board of UBS examined also other options for the future, in how to enable a better competitive position since their stock had been weak and undervalued for a long time. Both a strategic reorientation of the bank as an independent institution (organic growth and internal development) and a merger with one or more Swiss or foreign partners were discussed²⁰. But during the investigation phase the Board of UBS decided that the merger with SBC presented the best solution, since both UBS and SBC as international players in the financial markets would give the best premises for a strong new organisation. Both banks were established, traditional Swiss banks with a solid customer base. A key factor for this decision was also the fact, that since they were both Swiss banks, a cultural blending was not a major problem.

The merger was first announced on December 8th, 1997 by both of the companies' Boards of Directors and approved by the shareholders in February 1998. After some

¹⁹ For more details about merger history of both banks see
<http://www.ubs.com/e/index/about/history.html>

²⁰ <http://www.ubs.com/e/index/about/history/1990/1997.html>

consideration, the Board of Directors of the new bank decided that the bank should be named UBS AG. In order to distinguish it from the old UBS, the merged bank was referred to (for some time) as "the new UBS" or as "UBS AG"²¹. Nowadays it is simply called UBS, as its predecessor. The choice of the name of the new organisation reflected the power position UBS had, as well as its distinguished reputation. After all, the good name of UBS has been said to be one of the organisation's most cherished assets (UBS Annual Review 1998-2000).

4.1.1 Business units

The business structure of SBC and UBS has undergone some important changes during the last few years. Roughly said, these changes can be divided into three steps in the structural change. The merger was the primary motive to effect the structural change although both banks had already made some restructuring prior to the merger, which was the first phase of the major structural changes. The second major change occurred directly after the merger and the third one occurred after the bank acquired the US based broker PaineWebber in 2000. In the following I will describe the structural changes occurring after the merger and try to give a ground rule of the direction of the company's key competencies and where it is heading by this merger.

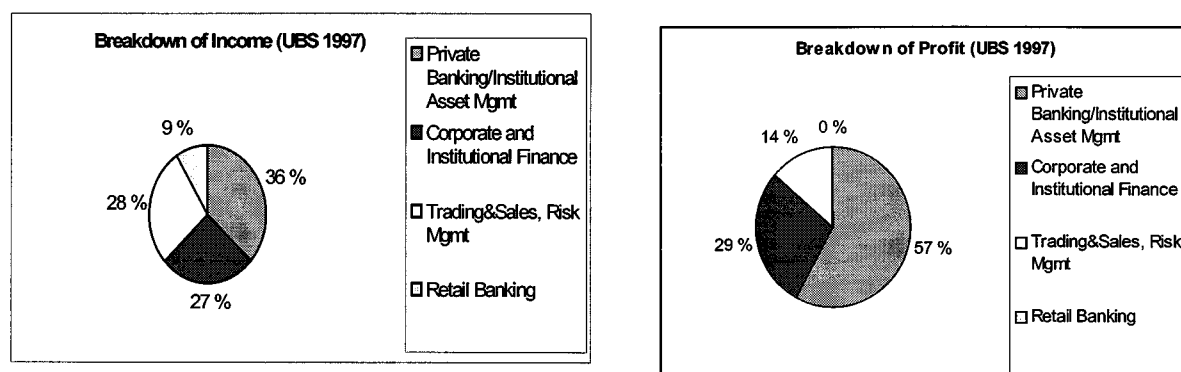
In 1997 **Union Bank of Switzerland** consisted of 4 business units:

- 1) Private Banking/Institutional Asset Management
- 2) Corporate and Institutional Finance
- 3) Trading & Sales, Risk Management/Group Finance
- 4) Retail Banking.

²¹ <http://www.ubs.com/e/index/about/history/1990/1997.html>

UBS' principal income generator was the private banking and institutional asset management business with a contribution of CHF 1,97 billion to net profit (58 %²²). Out of this, 85 % of the division's results were generated by private banking and 15 % by institutional asset management. The corporate and institutional finance division was in 1997 also a significant generator of profit. The segment's net profit was CHF 975 million (29 %) and the trading & sales and risk management services business' segment profit was CHF 461 million (14 %). The retail banking business posted a negative result of CHF –106 million in 1997, although its operating income reached CHF 1,164 million (28 % of the total income). The loss was a result of heavy restructuring projects, which had in some magnitude been started in UBS. The restructuring consisted of the closing of 30 branch offices, the bank's development and installation of machines with deposit and withdrawal functions (ATM's) and the development of Internet banking services. The business segment had been focusing on the core businesses, which is why UBS' subsidiary Bank Aufina was sold (Bank Aufina handled e.g. personal loans, which were replaced by overdraft facilities and credit cards).

FIGURE 3 Breakdown of Financial Results (UBS 1997)



²² Percentage from total profit without other unallocated profits

The **Swiss Bank Corporation** had reorganised its business lines and functions shortly before the merger, thereby trying to create a more results-oriented business culture. They had acquired some companies, which played a key role in their business of that time:

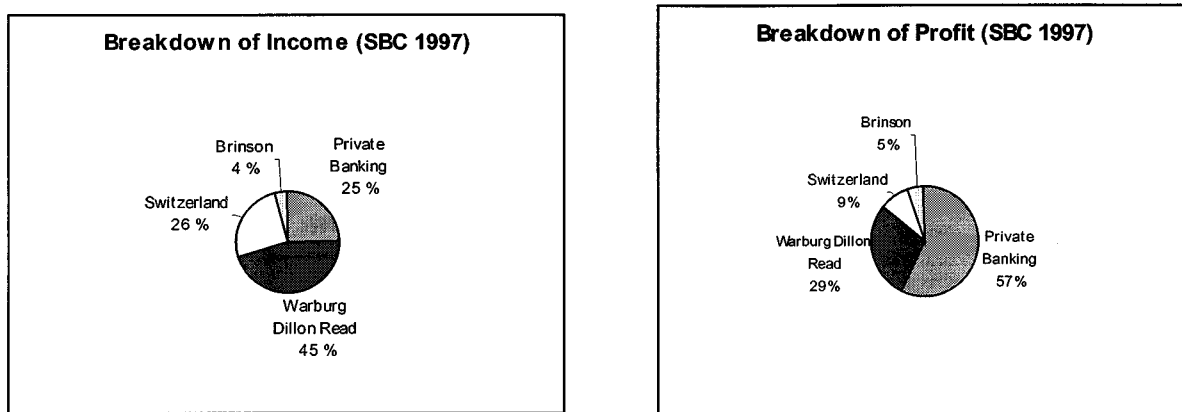
- Brinson Partners to increase their institutional asset management capabilities,
- S.G. Warburg and Dillon Read to expand their presence in investment banking markets

Both of them are in fact still the core of UBS' strategic development. In 1996 SBC's restructuring was completed, and in 1997, prior to the merger, the company had four business divisions:

- 1) SBC Private Banking
- 2) SBC Warburg Dillon Read (investment banking)
- 3) SBC Switzerland (personal, business and commercial banking within Switzerland)
- 4) SBC Brinson (asset management)

SBC Private Banking was a large contributor to the group's results with a net profit of CHF 1,563 billion (60 % of total profit). SBC Warburg Dillon Read had shortly before acquired the US investment company Dillon Read and was also an important income generator to SBC. Through the restructure, SBC Warburg Dillon Read tried to strengthen its influence in the corporate finance sector and especially in foreign markets, namely in the US. Its net profit was CHF 711 million (27 %). SBC Switzerland had also gone through restructuring, for example it had transferred all of its largest Swiss corporate customers to SBC Warburg Dillon Read. Nevertheless, SBC Switzerland remained to be an important part of the organisation, with a net profit of CHF 218 million (8 %). SBC Brinson's net profit was CHF 124 million (5 %). But already at this point it can be noticed, that wealthy private clients and corporations are the target group out of the clients and this becomes even clearer during the progression of the merger.

FIGURE 4 Breakdown of Financial Results (SBC 1997)



Before the actual completion of the merger, the decision had been made by the heads of both companies to restructure the new organisation in order to serve the needs of the markets and to accomplish a benefit of synergies by building a more efficient business structure (UBS Annual Review, 1997; SBC Annual Review 1997). Naturally an organisation consisting of two as important players in the financial markets as UBS and SBC requires some restructuring in any case (Vaara 1999, 8) and to find an appropriate business structure is probably one of the most challenging tasks in the process of merging.

The plans for the merger were, that UBS would get “synergy effects in all of its business units, especially in private banking and investment banking” (Marcel Ospel, President of the Group Executive Board, UBS Annual Review 1997). According to plans, UBS would top the list of all private banks around the world and have around CHF 600 billion in client assets under management after the merger, with expected profits of CHF 4,2 – 4,6 billion by the year 2002. In investment banking, UBS would occupy the commanding position in Europe with CHF 2,8 – 3 billion profits by 2002. But the new UBS was also expected to grow in other business areas, not only private and investment banking. In the asset management sector, UBS would be the fourth-largest institutional asset manager in the world with CHF 500 billion under management and expected profits of CHF 600 – 700 million by 2002. It would be market leader for consumer and corporate banking in Switzerland (expected profits by 2002: CHF 1,6 – 1,8 billion) and finally, the private equity business was planned to

take on a significant global position (expected profits CHF600 – 700 million by 2002). (UBS Annual Review 1997).

But, if we look beyond figures and expected results, there were also other operative plans and outlooks for each business area. Using the business segmentation of SBC (which was roughly used in the preliminary stages of the new UBS' restructurings) it is easy to summarise the goals of each segment.

First, the private banking business was "expected to benefit from the increased depth of expertise and a larger client base, providing further critical mass from the existing capabilities of both UBS and SBC" (SBC Annual Review 1997). The larger client base was seen to include also large international clients, reflecting the international expansion strategy. In this kind of strategy, the magnitude of the company, a well-known brand and a global reach should be the key factors.

Second, the investment banking business was expected to grow further, as it had been growing already during the mid-90's. In a broader time perspective, SBC's acquisition of PaineWebber in 2000 just underlined the direction of the previous goals to expand the investment banking business. It brought a large new client base to the investment banking sector in the US and the current merger wave expanded the client base even further. That particular acquisition strengthened UBS' position in onshore²³ private banking and wealth management. It gave an important platform for UBS in the US markets as well as strengthened its position in the M&A business in the field of international equity markets by delivering high quality professionals.

Third, the personal and business banking as well as commercial banking within in the Swiss markets were expected to gain from the merger through business synergies and economies of scale necessary to compete in the retail and commercial banking

²³ There are several definitions of onshore and offshore banking. Bankers often use the term onshore to refer to "tax-declared" money, as opposed to "offshore" which covers a large, but unquantifiable amount of money, which has not been declared to local tax authorities of the private bank customer.

market. In particular, synergy gains were expected to arise from technology and infrastructure investments.

Fourth, the asset management business was seen to gain from the merger by having a global reach to all the major markets in the world, thus minimising country risk and satisfying clients world-wide as well as gaining from economies of scale. However, these plans and goals evolved, as the merger progressed further and the real outlooks of the business segmentation did not become clear until the year 2000.

The core businesses of the new UBS were divided in 1998 into:

- 1) Private Banking
- 2) Warburg Dillon Read (investment banking)
- 3) Private and Corporate Clients
- 4) UBS Brinson (institutional asset management)
- 5) UBS Capital (private equity).

This represented a rather conservative division of the business areas, much similar to the one that SBC had prior to the merger. In fact, all of the key business segments, asset management, investment banking and private banking of SBC were transferred more or less directly to the new organisation. UBS on the other hand was restructured more heavily and some of its business areas were harshly divided to correspond with the structure of the new organisation. For instance, private banking was divided into two business areas and quite similarly happened also to the trading & sales, risk management services segment.

One interesting addition to the corporate structure of the new UBS was UBS Capital. This division had been built as a new major division in the company and clearly represented the company's interest in emerging markets and unquoted companies, which were UBS Capital's key competencies. However, the new UBS (from now on UBS) was still in the middle of the process of restructure and as can be read from the 1998 annual review, they were heading towards a "client focused structure" and in general, towards focusing on the operations surrounding their core products.

So, in the beginning of 2000 UBS' new business structure was announced, although the final version of its structure did not stress the above mentioned "client focus" of the company anymore. The new structure regrouped the wealth management businesses with the aim of "unlocking a potential to generate growth and a different way of thinking about client requirements" (Annual Review 2000). The investment services activities for international, wealthy private clients were seen to have growth potential, so that additional resources were activated in that sector. After the final restructure, the core business segments were regrouped to only three segments, which are the following:

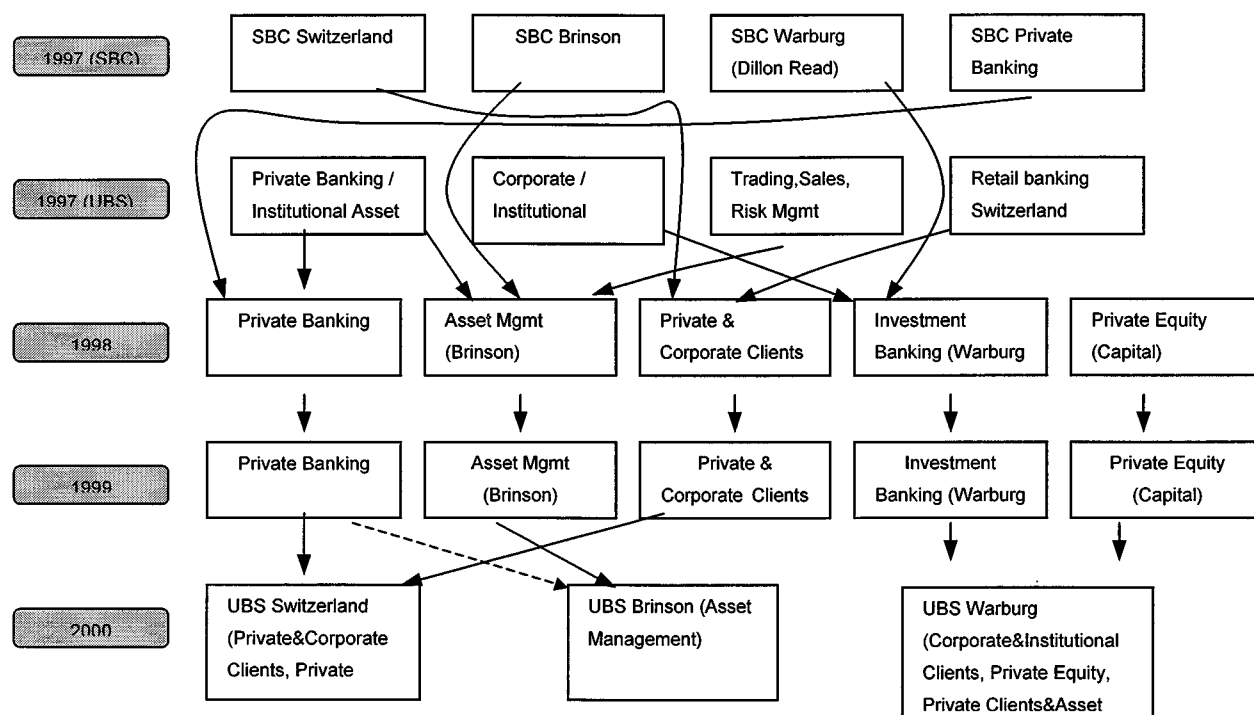
- 1) UBS Switzerland including private banking as well as regular retail banking
- 2) UBS Asset Management for both institutional as well as retail clients
- 3) UBS Warburg's investment activities

As one can see, UBS has been definitely focusing on its key competencies and it has simplified its structure heavily. "We have deliberately organised the bank along business lines, each with global functional management structure" (Ospel in *The Banker*, March 2001). In the income statement of 2000 the breakdown of income and profit is quite evenly divided between UBS Switzerland (operating income CHF 14,182 billion, 39% of total, profit before tax²⁴ CHF 5,675 billion, 55% of total) and UBS Warburg (operating income CHF 19,779 billion, 55% of total, profit before tax CHF 4,258 billion, 42% of total). UBS Private Banking had reached its goal through the restructuring and it is presently in control of the largest offshore private banking operation. The UBS group is very dependent on the strong showing of UBS Warburg, which had increased its influence in the group during the last few years, as was planned. It had in fact become the key profit maker in UBS' business activities. UBS Asset Management did not influence the result much, although all of UBS' asset management activities were brought under one roof. In fact, UBS institutional asset management operations had been suffering client defections since 1998, and a recovery had not been in sight until the second half of 2001.

This entire chain of restructuring and regrouping is presented in figure 4.

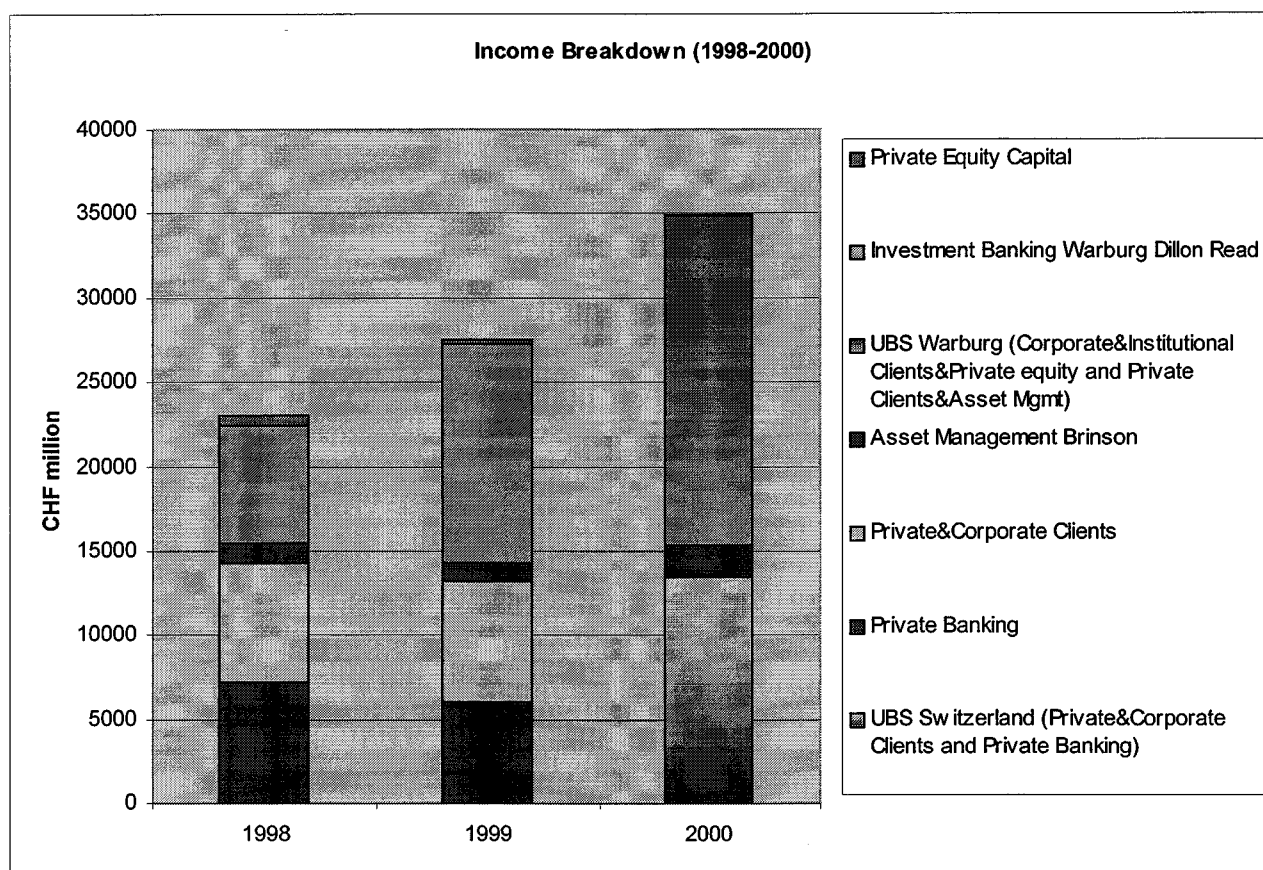
²⁴ Figures after tax not available

FIGURE 5 Presentation of UBS' business area development



Each segment's importance, which is measured through the segment's contribution to the total income, is illustrated in the following picture. It can be discovered that UBS has expanded particularly in its investment banking business, growing by 158 % between 1998 and 2000.

FIGURE 6 Income Breakdown (UBS 1998-2000)



The speculation of the correct motives behind the focus in private banking and investment banking including asset management is difficult. One can assume though, that a reason behind this strategic decision is the risk diversification of the company.

“In an ocean of financial turmoil private banking appears to be a sea of tranquillity and bankers are striving ever harder to find their way there. The prospect of high quality fee income has always been attractive but at times of volatile earnings in many areas, especially in investment banking, the stability and growth potential of private banking revenue streams have even more appeal” (Timewell, 1999).

UBS has actually diversified its business structure in two different levels, which is a common strategy for multinational corporations (Chkir & Cosset, 1999, 17 – 35)²⁵. First, UBS has diversified its geographical market risks by pursuing an international market diversification. The economies of both markets may have differing (or at least

²⁵ Both of these two diversification strategies represent two of five scenarios that Bower presented in the Harvard Business Review in March 2001.

lagging) market conditions and thus UBS can afford either market area's slowdown by relying on the better results in the other market. "(Geographic) roll-ups are designed to achieve economies of scale and scope and are associated with the building of industry giants" (Bower, 2001, 98). However, UBS has stayed out of the Asian markets and the reasons for this can be speculated to be in the cultural differences between Asia and the Western financial culture. The customer base of UBS is, without entering the Asian markets, a rather homogenous group, with similar needs, similar collateral system and a more or less uniform legal framework; altogether easy to manage. However, if the Asian customers were included into this homogenous customer base, then UBS would require a separate strategic structure and huge investments for those markets, in order to handle the Asian distinctive characteristics.

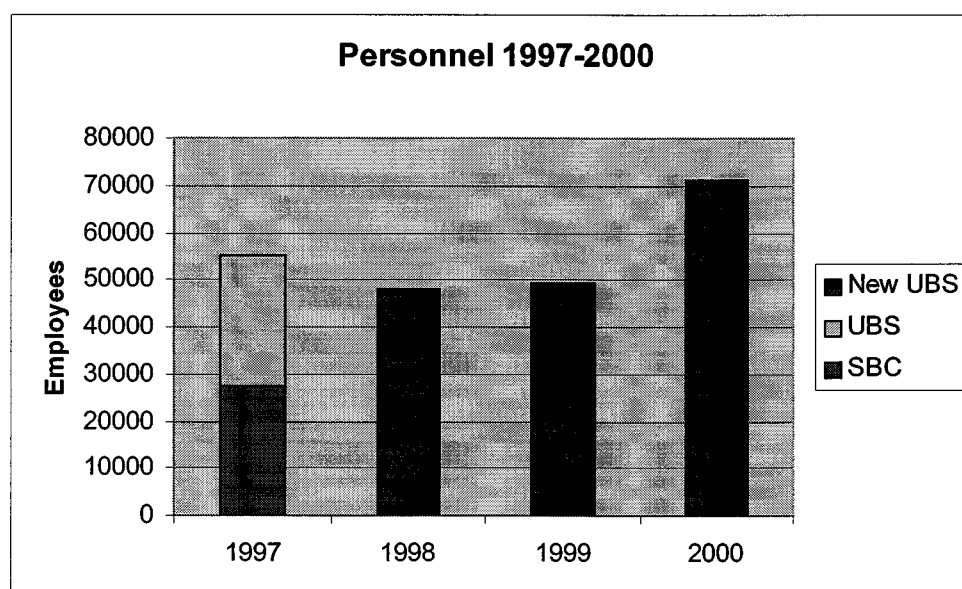
Second, UBS has diversified its product portfolio by moving from traditional private banking activities towards investment banking. Investment banking gives, during a financial upswing, higher profits and on the other hand, if the markets are going downward, it can rely on the safer business making of private banking (Timewell, 1999). The customer base of UBS has been driven towards wealthier clients and this has been a clear strategic decision. Since the customers of both activities are rather similar, the business lines support each other, on grounds of the contacts, image and the mode of business. The combination of both types of diversification has enabled UBS to achieve greater profits and lower levels of risk.

4.1.2 Personnel

After a merger, it is quite common that the headcount of the company is decreased, since several overlapping businesses are joined and employees may have too similar job descriptions (Heikkilä 1998). After all, why employ two of the same kind, when you can survive with one? Past merger cases have shown, that during the transition phase employees workloads are increased and new people have to be integrated into new organisation and its processes (International Labour Organization, 2001). This is usually not seen as a desired effect from the employees perspective, and therefore it is an important subject of research.

In the UBS case there has been the following structure of the personnel development. Directly after the merger the number of employees decreases as the overlapping posts are cut back, but after the synergy effects of the merger are coming to effect, the company starts employing new staff and begins to expand further. Naturally this expansion is closely attached to the present market conditions, therefore the personnel increase can not be seen to be generated purely because of the merger (International Labour Organization, 2001, 58), but still, some conclusions can be made.

FIGURE 7 Personnel Development (UBS 1997-2000)



In a more detailed examination of the personnel development it is found, that in 1997, when the merger was still in a planning phase, the CEO's and Board of Directors assumed that a total of about 13 000 positions will become redundant after the merger. This was about 24% of the total headcount of both companies (55 176 employees). The plan was to reduce the combined headcount over a four year restructuring period and the reduction would be achieved mainly through: 1) natural attrition, 2) early retirement incentives and, 3) involuntary redundancies where necessary.

In UBS, the number of employees had already fallen in 1997 by 1 542 to 27 611. This was due to consistent implementation of the restructuring in the domestic branch

network (e.g. sale of Bank Aufina in Switzerland reduced the employees by 300 persons), the reorganisation of trading operations in Switzerland and the consolidation of service centers. SBC on the other hand had increased its headcount by 75 employees during 1997, although it had let go over a thousand employees in 1997 from its personal and business banking sector (SBC Switzerland).

In 1998, UBS employed 48 011 persons (32 706 in Switzerland), 7165 persons less than the year before. The number of persons working in Switzerland (13%) had declined approximately in the same ratio as the number of persons working outside the Swiss borders (11%). The personnel costs of the company fell by 15 %, largely reflecting the reduction in headcount which had already resulted from the merger as overlapping functions had been eliminated. The elimination had occurred mainly through early retirements, outplacements etc., but also through involuntary redundancies, as they had planned before. The reduction was also partly due to the sale of the private banking subsidiary Bankca della Svizzera Italiana, which was one of the conditions, under which the Swiss Competition Authorities approved the merger.

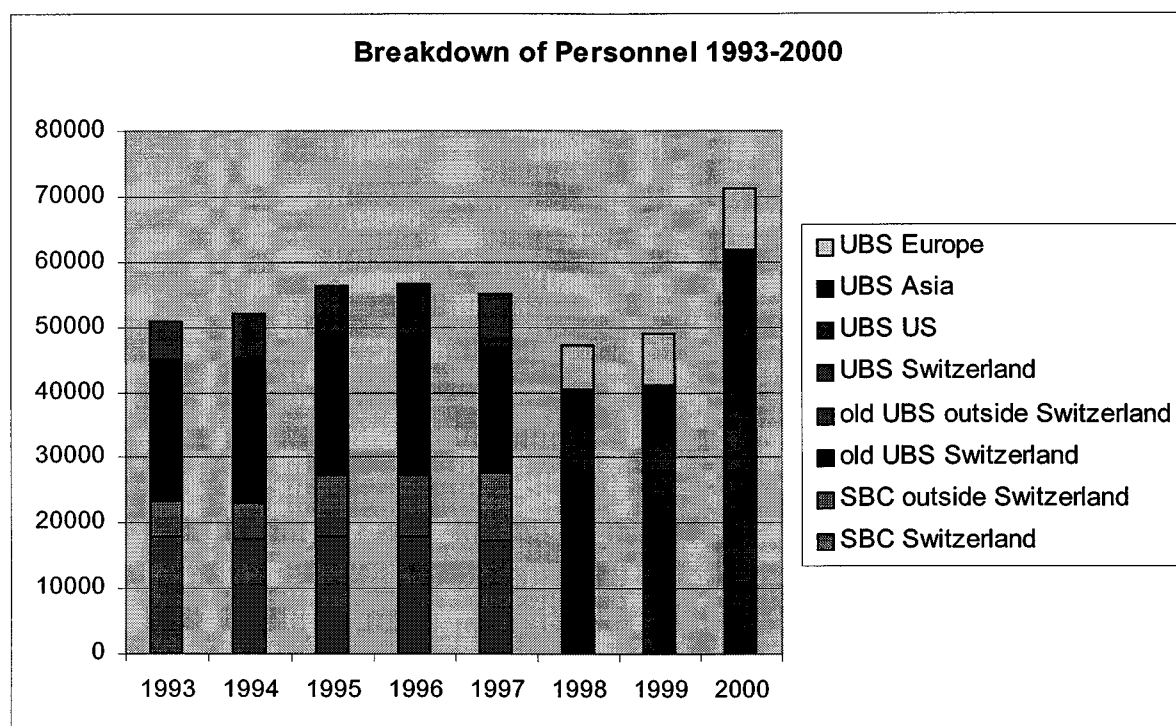
In 1999 the number of employees was rising again. At the end of the year, UBS employed 49 058 persons, representing an increase of 2,2 % or 1 047 persons compared to the year before. This increase was mainly based on heavy recruitment of young university graduates (700) and interns (500), since "it is essential that (UBS) identifies the managers of tomorrow today and gives them the training and resources they need to flourish" (UBS, Annual Review 1999). Altogether, the upswing of the banking sector gave UBS the possibility to invest their profits into new employees with fresh ideas. The employment culture of UBS was directed towards a younger family of employees, the target was to employ 700 university or college graduates a year (by the year 2000 the number of graduates to be employed had increased to 800 yearly) and for that reason the bank had invested in various induction programs within the organisation.

The year 2000 reflected a tremendous increase in the number of employees. In comparison to 1999, UBS employed nearly 45 % more persons than the year before. A great part of this increase was due to the merger with PaineWebber, which brought

26 500 (37 % of total headcount) workers previously employed by the US broker, to the group. The risks UBS faced in buying PaineWebber were substantial, since the acquisition of an investment bank includes even more risks than most other acquisitions. The reason for this is the sensitivity of the personnel, since they are the most important asset of a bank (Boxberg, 2001). It seems though, that the employment implications have not been very drastic and that UBS has been able to build a sustainable working atmosphere.

The acquisition of PaineWebber reflects a new structure in the geographic breakdown of employees, where nearly half of the employees work in the US. After all, in the past of UBS, the main geographic focus of employees had traditionally been in Switzerland. In fact, in the early history of UBS and SBC, all of the employees of the bank were required to have a permanent residence in Basle, Switzerland. But, similarly to the general trend of the bank, the personnel structure of the bank is heading towards more global markets, or at least expanding in the US. The Asian markets remain to be quite a small and insignificant fraction (5-7%) of UBS geographic breakdown, also representing the strategic withdrawal from the Asian markets, which was rationalised on page 53.

FIGURE 8 Geographical Breakdown of Personnel (UBS, SBC 1993-2000)



4.2 Kop – Ubf (Merita) – Nordbanken – Unidanmark – Christiania

The case of Merita and three other Nordic banks is complex. It involves two of the largest banks in Finland (KOP and SYP) as well as three other major financial institutions in Sweden, Norway and Denmark. It is an intriguing case also from an international perspective. The cross-border merger involving five banks of this scale is a unique transaction and it has reshaped the entire financial atmosphere of the Nordic countries "This appears to be the first major cross-border merger in Europe between retail banks (...) which can strengthen "Finanzplatz Norden" against competition from Brussels and Frankfurt and the large continental banks" (Barnes, 1997). Prior to this merger chain, all of the Nordic markets were considered to be separate geographical market areas, but as the situation evolved, the markets were unified to some extent and they were even seen to be one single market area. In order to narrow down the perspective, I have taken the liberty to examine this case from the perspective of the Finnish banks belonging to the present group. Naturally the perspectives of the foreign banks (Nordbanken, Christiania and Unidanmark) are equally as important, and would be an interesting subject of additional research.

KOP and UBF begun the merger chain...

The background of the first merger occurring in this transaction chain was the difficult situation of the two largest commercial banks in Finland, Kansallis-Osake-Pankki KOP (part of the Kansallis Group) and Union Bank of Finland UBF (part of the Unitas Group) in the 1990's. At that time, UBF and KOP were about the same size, although UBF was seen to be the stronger party in the transaction (Tienari 1996, 2-3; Kjellman & Nordman 2000, 23-24). They had both gone through four years of making losses²⁶ and their balances were weak. The bad results were partly caused by the overcapacity of banks and their bad cost efficiency as well as high credit risks and partly by the crisis situation on the financial market altogether (Vihriälä 1997, 167-172). The Finnish government had conducted a capital injection into the banking system in 1992 thereby becoming the largest single owner in both banks. That way the Finnish government was able to exercise some pressure towards a merger, since

²⁶ In 1994, KOP's losses were FIM 1,8 billion and UBF's losses FIM 1,3 billion.

it was in the government's interest to merge those companies. (Kjellman & Nordman 2000, 27). Noteworthy in the history of these banks is, that they had both gone through several mergers, UBF had in its past four mergers and KOP five mergers.

The merger of KOP and UBF was announced in 1995 and it was completed in three stages and altogether it was a rather confusing and complex transaction²⁷.

...which was followed by Merita and Nordbanken...

In October 1997 the boards of Merita and Nordbanken proposed to combine their businesses in new group called MeritaNordbanken, starting a chain of cross-border M&A's within the organisation. Nordbanken was at that point the second largest bank in Sweden. It had itself been the outcome of several mergers and acquisitions; it consisted of about 80 banks rolled into one entity during its history. Both Merita and Norbanken were approximately of the same value²⁸. MeritaNordbanken started its business in 1998, after the shareholders and the authorities accepted the proposal. In fact, the Swedish state owned 42,5 % of Nordbanken, having lessened its ownership since 1992, at which point the state owned all of Nordbanken's shares²⁹. Merita's subsidiaries' shares were transferred to MeritaNordbanken and Merita was planned to own 40 % of MeritaNordbanken's shares and 50 % of the voting rights³⁰. After this merger, it was obvious for many industry analysts, that the mergers in Scandinavia would continue, even though the players were not yet clear (Barnes, 1997).

²⁷ For a detailed description of the stages see appendix 2

²⁸ It can be questioned, whether this was actually the case, since the Nordbanken's balance was much stronger than Merita's. But in the beginning it was still the general opinion that both banks were equally strong partners.

²⁹ The Swedish state had decreased its ownership in Nordbanken during the 1992-1997 in several steps: 1992 it owned 100% of shares, 1995 it sold 34,5% to the public thus owning 65,5% of the company, in 1996 it owned 59,4% due to a share redemption, in November 1997 the state reduced it's holding to 42,5%. When Nordbanken merged with Merita at the end of 1997, the state's holding became 25,5% of MeritaNordbanken Group.

³⁰ For more detailed information about the merger structure see appendix 2

...and MeritaNordbanken's acquisition over Christiania...

In 1999 the situation evolved and the time was ripe for another major acquisition. Christiania Bank og Kreditkassen ASA (Christiania Bank) was the second largest bank in the Norwegian market and the oldest commercial bank in Norway. It had 4000 employees and the balance sheet total in 1998 was worth 200 billion Norwegian crowns. On September 20th, 1999 MeritaNordbanken announced its plans about acquiring Christiania Bank and told that it would pay NOK 44 for each Christiania share, which made the entire share capital of Christiania worth NOK 24,3 billion, making the bid 29 % over the market price of the company. The offer had been extended several times, which prolonged the acquisition project. By November, 2000, MeritaNordbanken had been able to acquire nearly 99 % of Christiania's shares and finally, in December, the Norwegian authorities granted Nordea (the name had been changed from MeritaNordbanken to Nordea, reflecting the words *Nordic Ideas*) a licence to operate in the Norwegian markets as a financial institution, thus enabling Nordea to acquire the rest of Christiania's shares. The approval of the offer was highly affected by the active support of the personnel and the customers of both organisations. The most problematic fact about the final decision to approve the offer was the ownership structure of Christiania Bank. The Norwegian state owned 35 % of the share capital of Christiania and prior to the final decision there was a complex political discussion in Norway about how to organize the state ownership in banks and what the future principles in financial questions should be³¹ (Hildén 2000).

...and MeritaNordbanken – Unidanmark's merger brought it to a conclusion

During the last phases of acquiring the Norwegian Christiania Bank, Nordea stated its interest in merging with Unidanmark, thus trying to broaden its geographical presence to the last of the Fenno-Scandic countries. Unidanmark was the result of the merger between two Danish financial institutions, Unibank and Tryg-Baltica, in 1999. As a result of this merger, Unidanmark had become one of the largest

³¹ The ownership structure development of Christiania was similar to the case of Nordbanken. In 1991 the Norwegian state owned the entire stock capital of the bank. By 1995 the government's holding was reduced to approximately 51% through a sale of shares to the public. The government holding was further reduced to 35% in 1999.

insurance groups in the Nordic region with a total premium income of DKK 16 billion. It had already at that point extended its operations to the Norwegian markets by acquiring the Norwegian insurance company Vesta.

The merger between Unidanmark and MeritaNordbanken was announced on March 6th 2000, even before the acquisition of Christiania had been finished. The merger itself was a relatively smooth transition to a new organisation structure. Both parties were in full consensus about basic structural, strategic and functional issues (Annual Review 1999). The strategy was still the same: a heavy focus on retail banking. Prior to the merger, Merita Holding and Nordbanken Holding (MeritaNordbanken was still legally owned by both holding companies) were joined to be one holding company, namely Nordic Baltic Holding. This simplified the ownership structure and enabled a smoother expansion.

4.2.1 Business units

The business units of Nordea have evolved in a quite straightforward manner. The structure of Nordea has stayed similar during the mergers, although some minor restructuring has been carried out. But, altogether a growing focus on the key competencies, especially retail banking, can be noticed and it has been mentioned as one of the main strategies behind the mergers, in addition to the further geographical expansion.

In order to get an overall view of the development of the business areas, it is necessary to review the merger starting from the UBF-KOP merger. The key fact about that merger was, that both organisations had a very similar business structure. They both focussed heavily on the banking business, having retail banking as their core business and other such as treasury, asset management and corporate & institutional banking as additional functions. Since the merged groups had such a similar business area breakdown, the conditions for eliminating non-relevant functions and reducing costs were good and that was probably one of the most relevant issues in the merger discussions.

The structure of the new Merita Bank included all of the above mentioned segments, being first divided into only three segments, namely retail banking, asset management and corporate & institutional banking. After some time, the structure of the business areas were revised and the treasury unit was separated from corporate and institutional banking. This obviously represented a need for a higher focus in its treasury business. In 1996 Merita decided to increase its Asset Management functions as well by buying a new Asset Management unit into the group.

In 1997 the merger with Merita and Nordbanken became topical. As Timewell and Warner (1999) had researched, the consolidation in domestic markets had already reached its peak and the cross-border mergers in Scandinavia begun. Obviously a geographic roll-up of the companies was designed to add to the economies of scale and scope as well as to build a banking empire (The Banker in November 1999; Bower 2001, 98). Nordbanken and Merita were quite similar organisations, as was the case in KOP and UBF also and this is seen to be a promising precondition for a successful merger (Barnes 1997, Blanden 1999). During the Merita- Nordbanken merger, the structure of the organisation was still quite unclear, even though the rough basics were planned to remain the same. The management was planning an even simpler and more focussed organisation structure. Especially the property holdings of Merita were reduced, in a faster pace than what was first planned. The organisation was reducing its ownership in many real estates in any case, but since the merger with Nordbanken the focus on real estates has been declared as unimportant.

From the following figures (Table 4.1) it becomes clear, that the Properties business had lost its importance by the year 2000 completely (the income of the concerned segment might not have been zero in that year, but still, the importance of it was so low and losing significance all the time, that it seemed more appropriate to include it in the "other incomes", than in a separate business area). Again, the focus in the key competencies has been named as a motive to these actions.

Since 1998, after Merita had merged with Nordbanken, it has been possible to observe the development of the major business areas according to their income

breakdown³². In 1997 the bank's operations were divided into four business areas (Retail Banking, Markets, Asset Management and Corporate and Institutional Banking plus additionally Properties even though it was not part of the banking functions). When the merger of Merita and Nordbanken was confirmed in 1998, the new organisation faced some restructuring and aggregation of business segments, although the basic structure stayed nearly identical. It still had the structure of four key functions.

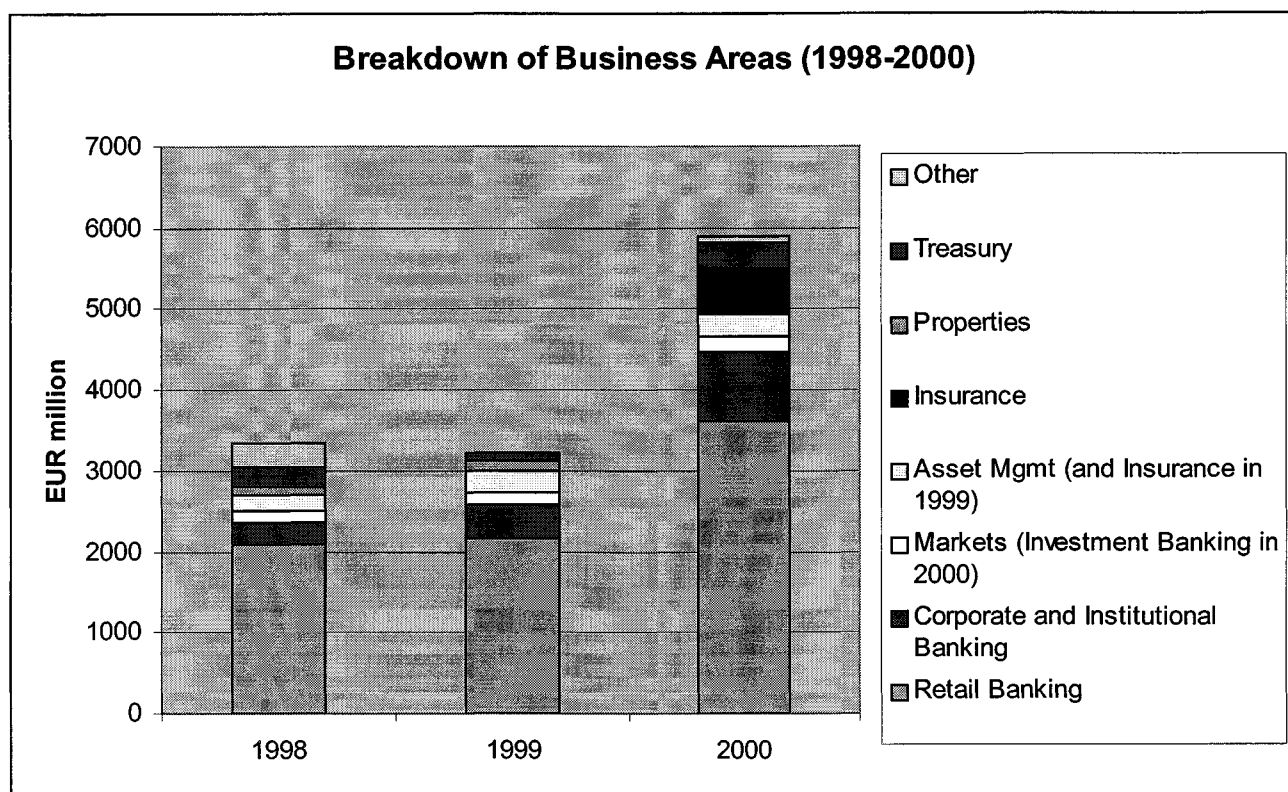
TABLE 4 Income Breakdown in Business Areas (1998-2000)

Income EUR million	Retail Banking	%	Corporate and Instit. Banking	%	Markets	%	Asset Mgmt (+insurance in 1999)	%
1998	2077	62%	274	8%	157	5%	202	6%
1999	2153	67%	425	13%	152	5%	270	8%
2000	3616	61%	859	15%	197	3%	256	4%
average		63%		12%		4%		6%

EUR million	Insurance	%	Properties	%	Treasury	%	Other	%	Total
1998			82	2%	248	7%	311	9%	3351
1999			113	4%	108	3%	-196	0%	3221
2000	581	10%			304	5%	83	1%	5896
average		10%		3%		5%		4%	

³² Before 1998 Merita did not release the breakdown of the result of major business areas

FIGURE 9 Income Breakdown in Business Areas (1998-2000)



As the financial results clearly indicate, retail banking has been generating a large part of the organisations income. This has remained unchanged during Nordea's acquisition of Christiania and its merger with Unidanmark. In 2000 the trend has been towards a slightly more insurance-based business strategy and the contribution of corporate and institutional banking has increased slightly, too. The basic strategy was to develop clear boundaries for each business area, in order to keep distinct spheres of responsibilities and a transparent business structure.

Nordea's retail banks in the Nordic countries are Merita Bank in Finland, Nordbanken in Sweden, Unibank in Denmark and Christiania Bank og Kreditkasse in Norway. The percentage of retail banking's income out of total income has been pending between 61 and 67 % during the last few years, and even though there are no accurate figures about the sector's contribution to total income during 1995-1997, it can be assumed that it has been about the same, if not slightly more. Since retail banking is,

according to the banks own researchers, “a lucrative business with a solid profitability” (Annual Review, 2000), Nordea is trying to broaden its product selection in the retail banking market. New products have been launched and the special factor in the retail banking business has been the development of Internet banking, which does not raise the overall costs much and makes the retail business even more profitable. Nordea has already built the most comprehensive retail banking-network in the Nordic countries with 1 256 branch offices and is trying to expand its business into the Baltic area. The synergy effects were planned to arise from a broader product portfolio since all of the companies services will be combined, a joint development of new products and services especially in the Internet banking business and the elimination of overlapping functions.

The acquisition of Christiania Bank brought Nordea the wished-for addition into the Corporate and Institutional Banking business. The Corporate and Institutional Banking more than doubled its income during last year (2000), which makes it obvious, that the last two transactions with Unidanmark and Christiania have generated some benefits to that particular business area. If the information of the transactions is examined in more detail, it can be noticed that especially Christiania's Shipping, Offshore & Oil Services-business was a great addition to the segment's profit. The strategy of Corporate and Institutional Banking business has been to build a unified Northern market, in which the bank can supply the clients with different products. The central element of this strategy is that the markets are not divided into geographical markets but into product specific markets, which benefits especially the Finnish and Swedish markets and clients, since it has not been available in these countries before. The most important generators of synergy benefits have been the aggregation of branch offices, the combining of the previously separate Markets-unit's businesses and the profits caused by an increased competitiveness.

Investment banking is one of Nordea's focus areas, which became clear in 2000. The investment banking function of Nordea had been tossed from one business area to the other and even the separate functions within investment banking had been integrated to other business segments. For instance in 1997, in conjunction with the merger with Nordbanken, the trading and capital market functions of the prior Merita Investment Bank were transferred to the Merita Markets business area, whereas the

asset management and treasury functions were integrated to Asset Management. A very confusing development altogether, especially since all investment banking activities were transferred again in 1998 under Corporate Clients business. In 1999 the investment banking activities once again faced a restructure, when they were united with Maizels, Westerberg & Co³³ and renamed to MNB Maizels. This was a key factor in the continuing focus in pure investment banking and it was carried further (the name was changed to ArosMaizels). It had two principal functions, namely Equities and Corporate Finance, in both of which it is one of the largest actors in the Nordic region. Ever since the Corporate Finance unit of Christiania joined ArosMaizels, it has had a strong local knowledge and presence in each of the geographical market segments, which is an important asset in Investment Banking. Nordea has built its position even further by complementing its knowledge also in the British and US-markets through branch offices.

The Asset Management business area has lost some of its importance in comparison to the previous years. Its contribution to the total income of Nordea decreased, even though the assets under Nordea's management increased by 18% to a total sum of EUR 104,8 billion (increase of EUR 15,8 billion). The acquisition of Christiania increased the assets under management by EUR 3,1 billion, representing only a few percents of the total sum. Nevertheless, Nordea's Asset Management business has clearly gained from the expansion into the Norwegian and Danish markets by getting a number of new investment possibilities. The emphasis in this sector has been shifting from domestic investment products towards more international markets and from simple bonds towards more complex securities and that is why broader market knowledge is highly recommendable. If the market shares of all Nordic banks in the investment funds are considered, Nordea has been able to become, through its mergers, a market leader with 21% share of the entire market (FSPB Robur 19%, SEB 12%, Handelsbanken 6%). The interesting difference between both of these cases (UBS and Nordea) is, that Nordea has linked its Asset Management business and Private Banking function together. In UBS this is not the case and it probably reflects the different client structure of the banks. UBS has an abundance of wealthy

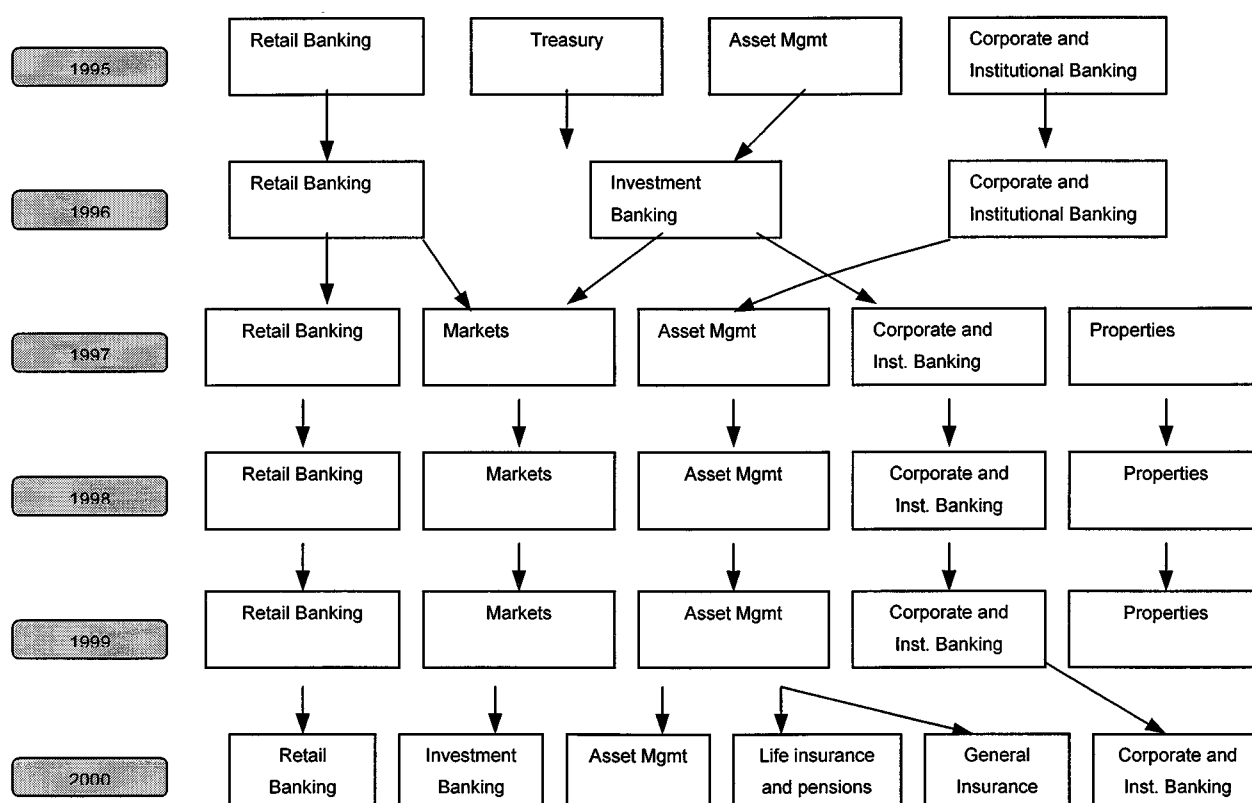
³³ The originally Swedish Maizels, Westerberg & Co. had knowledge and experience especially in the field of M&A's.

private clients, requiring a specific asset manager for their possessions. That is why UBS has found it necessary to have an entirely separate business area for those customers. In Finland, Sweden, Norway or Denmark there are not many people having the need for such services and if they had the wealth, they would probably transfer it to foreign banks anyway. One can search for the reason in the unique preconditions of Swiss financial markets, as described in the third chapter.

The insurance business is a new focus area in comparison to the traditional portfolio of services of Nordea. Traditionally Nordea (Merita) has had insurance activity to some extent but it has not been one of the main business areas, but it has been merely a part of the Asset Management business. In fact, its share of the income of that particular business segment was less than 15% in 1998. Still, Merita Life Insurance was the market leader in Finland in the life insurance markets with a market share of 27,7%. In 1999 it had increased its share to 22%, which represented a definite increase in the demand of investment bound insurances and retirement pensions. The same development could be noticed in the Swedish insurance business, as well. But what is interesting in this business is, that the different geographical areas could not be considered as one united market, since the pension systems, insurance legislation and taxations of each country differ from each other. That's why the insurance business cannot be centralized and it does not face similar synergy advantages as other areas of activity. Still, Nordea has planned to unite some of its functions and find synergy effects by focussing in growing the volume of its assets and possibly developing some insurance products similar for all the Nordic markets. Such products are e.g. investment bound insurance products, private pension funds, Internet insurance products etc. The acquisition of Christiania has meant, that all of its previous insurance products will be joined to the Nordea portfolio completely.

The development is easier to follow through a visual presentation:

FIGURE 10 Development of business areas

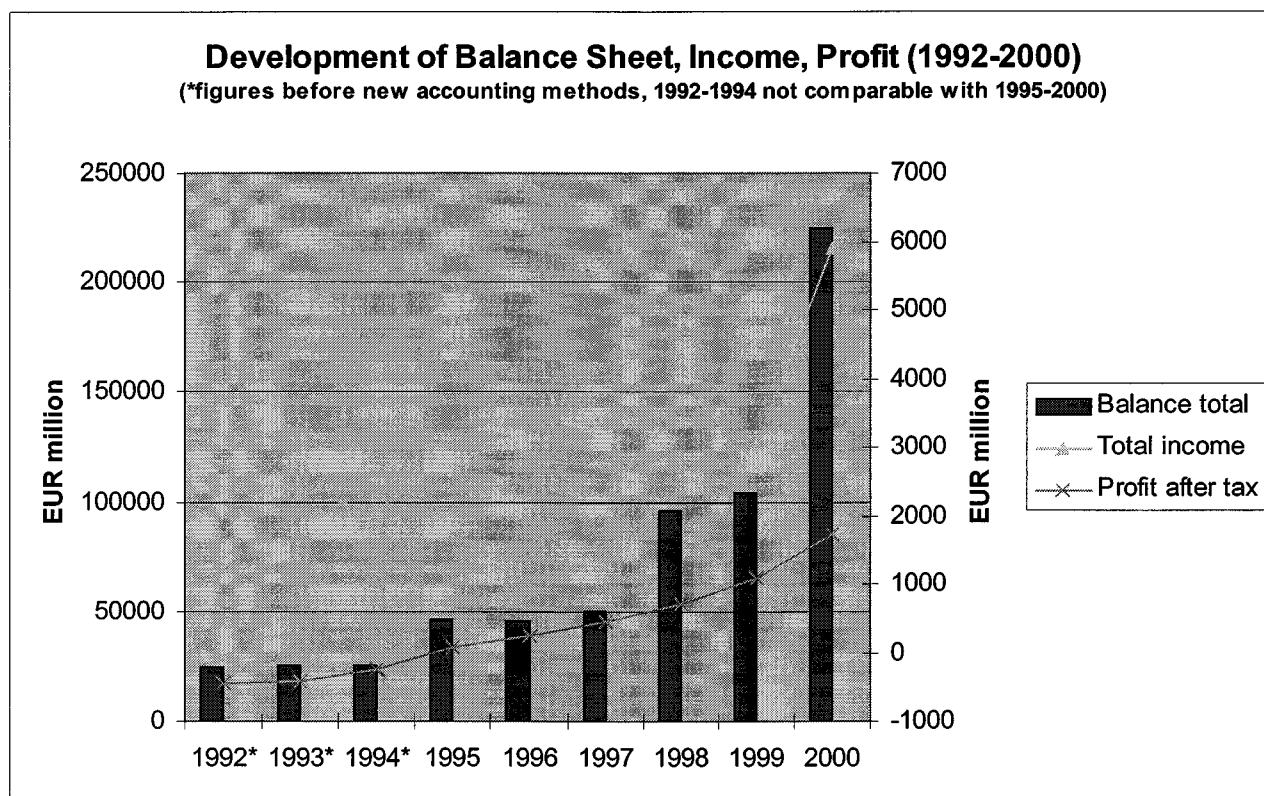


In general, the figures of Nordea's business development indicate, that the company is focussing especially on those business areas, which have the biggest growth capacity. These growth sectors are asset management, investment banking and insurances. Without paying any attention to the recent (since 2001) development of Nordea's business structure, it can be said that the structural change has been successful and the financial results have been encouraging. No other financial institution in this geographic areas has been able to construct such a market leading position, even though there have been some attempts, e.g. Sampo, Handelsbanken, Den Norske etc. The key creator of this success has been, as already previously noted, the focus on the important business areas and the elimination of non-relevant ones. Size has created synergies, especially in the retail banking segment, and that is according to Timewell and Warner (1999) the driving force behind the merger.

Figure 4.8 clarifies the development of Nordea's financial figures and it is clearly noticeable that its income and profit levels have increased in a steady pace since 1992 (the figures from 1992-1994 are from Merita's predecessor Unitas, 1995-1997

from Merita, 1998-1999 from MeritaNordbanken and after 2000 the figures are representing the entire Nordea group). The mergers show a clear rise in the balance sheet's total, which is a normal reaction after a merger.

FIGURE 11 Development of Balance, Income and Profit

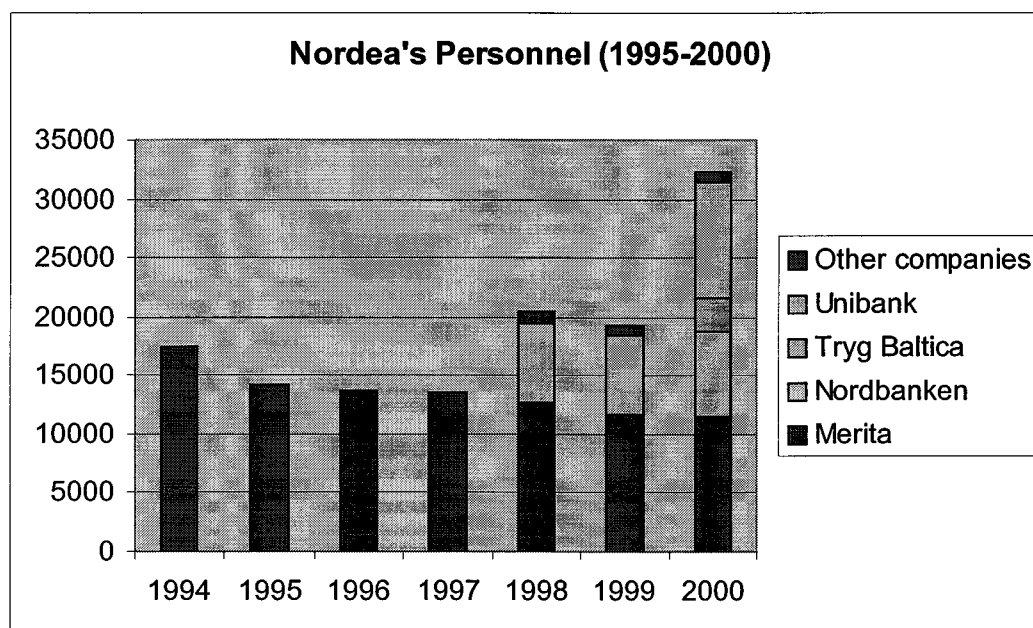


4.2.2 Personnel

The number of employees in Nordea has been a difficult topic, especially during the first merger between KOP and UBF. The social impacts have been researched by Titi Heikkilä (1998) in a study focussing on the personnel's feelings about mergers as well as by Janne Tienari (1996) focussing on cultural issues. In general both have noticed, that it has been difficult for the personnel to adjust to the new organizational structure. I will leave the analysis of the social implications at that, focussing more on the quantity impacts of the mergers.

In the first stages of Nordea's merger chain, the situation of both banks (UBF and KOP) was so difficult, that large cost reductions had to be carried out and numerous involuntary redundancies occurred. In fact, the headcount has increased only through the succeeding mergers and acquisitions. An organic growth of personnel has been a minor factor in the growth of the organisation.

FIGURE 12 Breakdown of Personnel (1995-2000)



The year 1995 was the first year, where the reduction of headcount reduced the total personnel costs. The number of employees was reduced by 3140, which represented a slightly larger amount than what was planned prior to the merger. At the end of 1995, Merita Bank had 14 606 employees and it was planned, that by 1997 the total headcount would be reduced to 12 000 employees. The reduction had been a major factor in the high level of the extraordinary costs of the income statement, since nearly all of the personnel leaving Merita were compensated with large compensation packages, totalling to an amount of FIM 442 million. As had been noticed in the prior part of the research, the similarity of their business structures allowed the elimination of overlapping functions and reduction of costs. Especially overlapping branch offices were closed, which was an important factor in the personnel policy as well. Since both KOP's and UBF's employees had similar job descriptions, it was not lowering the bank's efficiency to let part of the employees go and thus achieving large cost savings. The other factor, which allowed such great personnel cuts, was the fact that

so called back office and administrative functions were centralized, thus requiring fewer employees. According to some of the employee's personal perceptions, the personnel cutting process reflected the power position UBF had over KOP (as was already noted in the background study). The managers of UBF were given the first option in nearly all of the management positions and KOP managers got those, which were left.

By the end of 1996, Merita Bank was the employer of 12 853 people, 1753 less than in 1995. As can be seen, Merita was further accentuating its personnel cuts and by 1997 Merita had achieved to make the job cuts, which the merger had made necessary (by 1997 personnel had been reduced to 12 703).

The merger with Nordbanken had set again new plans for personnel reduction in 1998. The plan was to lessen the total headcount of MeritaNordbanken by 2 000 employees within three years. Merita, in particular, was required to bring its staffing down to the Nordbanken level, in order to reach the planned cost reductions (Barnes, 1997). So even though the total headcount of MeritaNordbanken had obviously grown, the share of Merita's employees had been reduced. The net reduction of MeritaNordbanken's personnel was 616 employees during 1998. It can be noticed already at this point, that the working climate of Merita and its successor MeritaNordbanken was quite insecure for some employees, based on the heavy changes in the company structure and thus in the personnel structure as well. This was not the end of insecurity in the company, as there were still some restructurings to come. Still, the overall satisfaction amongst the employees was, according to a query, on a good level.

In 2000, the headcount of Nordea exceeded 30 000 employees (32 218) as a consequence of the merger with Unidanmark and the acquisition of Christiania and in 2001 the company reports that its headcount has exceeded 38 000. Noteworthy about the current development of personnel policies is, even though its not directly related to the merger effects, that especially retail banking is decreasing its headcount. That is based on the larger investments in Internet banking, which makes it possible for customers to take care of their own banking transactions via the Internet, thus requiring less personnel in the branch offices. So, in fact, the reduction of personnel

in branch offices can be caused by overlapping positions after a merger or by the decreased need of cashiers because of Internet banking. Whatever the actual reason behind the reduction is, the fact remains, that the personnel of Nordea is undergoing a structural change.

Nordea's employment effect follows a traditional advancement of merger implications. For example Rhoades (1998) studied the efficiency effects of bank mergers and found that mergers result in significant cost cutting, especially through the decrease of headcount. The International Labour Organization has also found that "M&A's imply immediate and direct job losses", even if they may generate other jobs (e.g. through providing credit to another sector).

The geographical structure of the personnel breakdown has been shifted from Finland and Sweden more towards an inter-Nordic breakdown. The accurate number of personnel in each country is not applicable from the annual report of Nordea, but the number of employees in each part of the group (Merita, Nordbanken, Unidanmark and Christiania) as can be seen in figure 4.10 gives some suggestions about the geographical setting. The headcount is in Finland and Norway the highest and also Sweden's share of the total headcount is quite significant.

5 COMPARISON ANALYSIS

Many researches (e.g. Timewell & Warner 1999, International Labour Organization 2001, etc) indicate that usually the main motives behind mergers are:

1. Cost savings and
2. Creating shareholder value

But as Bower (2001) notes, “the thousands of deals that academics, consultants, and businesspeople lump together as mergers and acquisitions actually represent very different strategic activities”. Also in both of my cases the mergers as well as the motives behind them are distinctive. It can be presumed, that the search for size in order to compete in a global banking environment (Blanden 1999; Blanden, Ghavimi, Baker-Self, Partridge, 1999; Kleinert 2000; Timewell & Warner 1999) is in fact a motive behind both the UBS mergers and the Nordea mergers. “You can’t stay a small retail bank because progressively you will find you can’t deliver the right product at the right cost. It’s a pan-European problem” (Philippe Sacerdot, managing director at UBS Warburg in the Financial Times Industry Survey 2001). The global expansion of all the major financial institutions around the world has turned banks to large international alliances, from which the structures are complex³⁴. But apart from that there are not many same motives behind or developments after the mergers.

When comparing UBS and Nordea with each other, a similar development has occurred through the focus in some functions and the elimination of non-relevant activities. But a very distinguishing characteristic about both of the mergers is the basic strategy behind the activities of the companies. Nordea has kept retail banking as its most important key competency, since it has traditionally done well in that sector and has not been intrigued by penetrating into other markets. Its goal has been to build a powerful Fenno-Scandic retail bank and this goal has been obvious in all of its recent mergers and acquisitions. As Michael Blanden (1999) argues:

³⁴ http://www.thebanker.com/archive_frameset.html

“most of the activity has involved in-market, concentrating mergers among institutions with a similar business mix and geographical scope (...). This type of transaction offers the most obvious potential for value creation through cost synergies as well as mechanism for building the scale necessary to respond to the key strategic challenges facing financial institutions”.

Exactly this has been the strategy behind Nordea's mergers, since especially retail banking is that particular sector, in which most of the cost savings can be made. The strategic positioning in Nordea's case is in fact a two-level positioning, firstly an access-based positioning, the choice of a distinct geographic area (see p. 26, Porter 1996, 65-66) and secondly, a needs-based positioning, where the company chooses a particular target group of customers (see p. 25-26, Porter 1996, 65-66).

The access-based positioning can be rationalised by the necessity of geographic presence in the retail banking business. A common new access-based positioning is the customer's access to the Internet. This has been taken advantage of in the Nordic banking world, where a great part of the routine banking business is handled via the Internet. It has enabled significant cost reductions, even though a palpable presence has remained to be important as well. And even though segmenting by access is less common and less well understood than other kind of positioning, it has been used especially in the Nordic banking environment. The long distances and sparsely situated customers have enabled the access-based positioning to be a productive option.

The needs-based positioning of Nordea can be seen in its specialization in normal, domestic, middle-income customers in need of e.g. deposit, credit and minor investment services. Nordea is aiming to take care of more or less all of this target group's financial needs, which are mostly routine banking services. It is, in fact, quite a wide area of specialization, but it has been discovered to be productive in the Nordic markets. The reason for this can be found in the Nordic banking market structure. There are only so few retail banks, from which the customer can choose. And since the population in all of the Nordic countries is rather small, the absolute number of customers stays also relatively small, in comparison to international banking giants. Thus the wide specialization area stays easy to handle.

In this context it is also important to mention the requirement of size. Retail banking requires, in order to stay competitive, a large size. A sufficiently large size means, that the bank is capable to handle also the accounts of larger Nordic companies, without a significant risk concentration. But it also means, that the bank is large enough to protect their own market situation by posing a barrier for smaller companies trying to enter the financial markets. By enlarging the organisations size, especially through mergers and acquisitions, overlapping networks can be eliminated and cross-selling of other products can be achieved. However, according to Porter's distinction between operational efficiency and strategy (p. 22), this particular achievement (elimination of branch offices, introduction of new products) may also be part of an increase of the operational efficiency and not necessarily an outcome of a strategic choice. It is impossible to disentangle which of those two concepts is dictating Nordea's actions, and most likely it is an interaction of both.

The point of surprise in Nordea's mergers has been, that they are in fact cross-border mergers.

"Cross-border mergers have taken place in Scandinavia and Benelux where the biggest banks in small countries have had to look outside their domestic markets for expansion. But outside Scandinavia with its closely linked history and culture, these mergers have rarely led to full integration but a collection of businesses under a single group" (Willman in Financial Times, Freeze or jump? That is the question).

Cross-border mergers between retail banks are usually a rarity, since it is considered, that "they do not offer the opportunities for rationalising the branch network and slimming man-power, which are invariably the major attraction of mergers between domestic retail banks" (Barnes, 1997). The fact of whether or not the Nordic markets should be considered as one market, making the mergers just in-market mergers or whether these markets are still so distinctive that the mergers should be considered as cross-border mergers, is an important field of additional research. However, another point of view is considering Porter's discussion of globalisation's impact on strategies and how it may not even disturb the basic strategy of the company. By doing that, we can conclude, that Nordea is simply growing in consistency with its retail banking strategy, opening up larger markets for a focused strategy. Unlike broadening domestically, expanding globally is likely to leverage and reinforce a company's unique position and identity. The fear of not having superior knowledge of

the new market areas is eliminated through acquiring and merging with companies having already a distinguished brand name.

The downside of Nordea's merger activity within the Nordic area is, that it still stays dependant of the Nordic countries economic fluctuation. Since the economic cycles are quite simultaneous within all the Nordic countries, Nordea has no risk diversification in the geographical sense. The future will show, how Nordea is able to fight against its strong predisposition to the simultaneous recession trends.

The ground-giving strategy of UBS activities, on the other hand, has been, especially outside Switzerland, its explicit focus on investment services: wealth management, asset management and investment banking. It can be noticed, that UBS has in fact redefined its basic strategy towards a worldwide investment and private banking company. This became clear at the latest in 2000, when UBS acquired PaineWebber in the US. The world's leading banks, including UBS, have become more diversified through this kind of mergers and acquisitions, relying less on profits made from lending to companies and individuals. Over the past 10 years, most large banks have targeted fee-earning businesses such as private banking, wealth management for the mass affluent, custody services for institutional investors and bancassurance (Willman 2001, Cross-border mergers: Fear of becoming takeover candidates).

The strategic positioning of UBS' business has been also two-levelled. Most likely they have pursued a needs-based positioning (see p. 25-26, or Porter 1996, 66), where they have defined a target customer group and a variety-based strategy (see p. 25 or Porter 1996, 66), where the company has made a district choice of products or services. The needs-based positioning consists of a target group of wealthy clients, who are willing to give their assets for UBS to manage and for whom UBS is willing to serve all the required services in asset management and private banking. Because of UBS' world-wide reach, it can easily market its services for a variety of wealthy customers around the world. Since there is a minimum of investable assets, the likelihood of finding enough customers within Switzerland remains relatively small. However, broadening the geographical presence, they can reach considerably more wealthy clients. The effect of this kind of a specialisation is a highly personalized service standard for a restricted group of clients, thus leading to a high

return on equity. Within a group of wealthy clients, loans, which traditionally pose a risk for financial institutions, are rarely required.

The variety-based positioning manifests itself through the choice of service varieties, which in the UBS case is investment banking and asset management. For a bank, that started off from a business unit division of five main activities and developed to a bank of basically two main activities, this strategy is evident. Variety-based positioning makes economic sense when a company can best produce particular services using distinctive sets of activities. In UBS' case this distinctive set of activities is investment banking and private banking, which is in fact a strategic fit (see p. 54).

The geographical strategy of UBS has been the absence from the emerging markets in Asia. The geographical diversification is already sufficiently wide spread amongst Europe and USA and it does not need a further diversification in order to reduce market risk. In addition to the market risk, UBS has, through its non-attendance in the Asian markets, been able to keep its credit risk quite low.

So, basically, the strategy of UBS is quite different than the one of Nordea. Where Nordea has stayed in the well-known market of retail banking, UBS has switched its core competency from private banking within the Swiss markets towards worldwide investment banking services and asset management services to wealthy customers. It has not only broadened its geographical market presence from Switzerland to the US, but also its product line from traditional banking services to asset management and corporate finance. Another fact, which has been driving the UBS mergers, is the company's belief in a pan-European consolidation: "I believe our industry will end up structured something like the world oil industry. There will be a few large electronic banking firms, challenged by a competitive fringe of smaller niche players" (Ospel to Financial Times in Freeze or jump? That is the question).

If we consider Berger's division of motives behind bank mergers, which are characterised in the second chapter of my study, all of the motives can be found to some extent in these cases, even though through different implementations.

Especially the **value maximising motives** have been playing a big role in the mergers.

Increasing efficiency is probably seen more clearly in the case of Nordea and especially through its significant reductions in headcount and branch offices. UBS has also increased its efficiency, but since its retail banking business has been rather small in comparison to the other functions, its efficiency increase has not been able to have such profound impacts. So, it can be seen, that in Nordea's case the economies of scale have played a more significant role than in the UBS case. In addition to that, efficiency-increasing factors include also economies of scope, which on the other hand have been significant for UBS. It has found advantages in providing a broader mix of products, namely by broadening its investment banking services.

The *increase of market power* has become quite clear in both UBS' and Nordea's motives. But here the difference lies in their distinctive markets. Nordea faces a particular geographical market within the Nordic countries. It does not show a large interest in trying to broaden its geographical market presence to other European countries (outside the Baltic region), without even speaking of the US. Nordea has achieved a strong market position in that market and if we narrow down the market especially to retail banking, it is clear that Nordea has the largest market power in Fenno-Scandia. In contrast to that, UBS' market is global, so it would be ridiculous to compare these two banks by market power. The competition between them is minimal, and they do not offer the same portfolio of products. The merger of UBS and SBC and their acquisition of PaineWebber have increased UBS' market power greatly, even though the market area is broader. According to Diane Glossman, a banking analyst at UBS Warburg in New York, the "risk is better spread around the markets than it used to be. The risk still exists and somebody holds it - but the banks hold less" (Financial Times, 30.11.2001). Both of these banks are the largest players in their distinctive markets and are therefore able to influence the market price and market development.

The interesting fact about the competition level of the banking sector is its connection to macroeconomic activity. As Smith (1998) researched, "bank market power (...)

reduces the level of macroeconomic activity". Boldly taken, this may have had an impact on the situation Europe and the US are facing now. Switzerland's stage of bank consolidation is "substantially completed" (Credit Suisse Group in the Banker, Feb 1999) and the Nordic countries' position is not much different (Timewell & Warner 1999). So, when these facts are combined with the abovementioned assumption of Smith, it can be speculated whether or not the recent downward trend has a connection with the high concentration level of the financial sector. This would be an interesting point of additional research.

Still, there remain the **non-value maximising motives**. *Managerial motives* have played some role in the Nordea mergers (Kjellman & Nordman 2000). There has been an obvious attempt to build a Nordic banking empire (Barnes, 1997) and this may be pursued in order to gain more personal power and financial compensation. The financial compensation of the highest-ranking officers has increased tremendously, from EUR 2,5 million to EUR 6 million and the power has exceeded the traditional levels of domestic bank managers. In UBS' case this is not much different. Since UBS is the third largest bank in Europe measured by its market capitalization, it is clear that its managers have an incredible amount of power in the financial markets (the financial compensation figures of the highest ranking officers have not been made public).

Since the *authorities involvement* in bank mergers mainly emerges from the regulation of banks, the prevention of financial failures or from government ownership, the close relation of Nordea to these motives is undoubted. After all, since the Finnish government did own a large part of UBF and KOP through its capital injections, it had a significant authority to decide on the continuation of the banks. It had to prevent the financial failure, which would otherwise have been inevitable. The local governments of Sweden and Norway where also large owners of Nordbanken and Christiania, so basically the same motives where behind those transactions as well. Even though the banks did not face a crisis situation in 1997 or in 1999 anymore, the privatisation process was well on its way in all of the Nordic countries and that strengthened the authorities' need to restructure.

The authorities involvement did not play any significant role in the merger of UBS and SBC. They were both completely privately owned banks and the only point in which the authorities took part in the merger, was through the antitrust policies. UBS had to sell its private banking subsidiary Bankca della Svizzera Italiana, which was one of the conditions, under which the Swiss Competition Authorities approved the merger. Still, it is not certain, that behind the scenes the Swiss government did not encourage the UBS-SBC merger. Since there were also preliminary propositions to merge with foreign financial institutions, it can be speculated, that the authorities much rather saw the banks to merge with eachother, thus keeping the business in Switzerland.

One additional point of view is the special feature about the banking environment in Europe, namely the single currency area, which requires a "new breed of super-banks able to compete across euroland and face up to the US giants" (Blanden, Ghavimi, Baker-Self, Patridge, 1999). Economic pressures from the euro may be greater than assumed and banks may have to raise more capital or consolidate in order to stay in business (Pretzlik, 2001). Competition will be stimulated, promoting the creation of larger businesses able to use their scale to reduce costs.

This challenge has been solved by both banks in different ways. UBS has solved the problem by acquiring a strong US-based bank, thus being able to compete with the US banks in their own markets. In contrast to that, Nordea has decided to remain in its local markets and trying to get a market-leading position there. The Nordic markets are quite distinctive and small to raise a direct interest in the global banking giants. Thus it is likely, that they will not face a tough competition from them.

The comparison between the development of the personnel structures of UBS and Nordea shows also differences in the policies of the companies. The headcount of Nordea (Merita) has been decreasing since the first merger, if the merger-driven personnel increases are not taken into account. A tendency towards cost reductions in the personnel section is clear. In fact, according to the International Labour Organization (2001, 44), staff and branch rationalization in Europe has been most extensive in Scandinavia. In contrast to this, UBS' personnel structure development has had an increasing trend. Directly after the merger between UBS and SBC some personnel reductions were implemented, which is common after a merger. But, in the

following year after the merger, UBS' personnel was increasing again and during the second year after the merger UBS' staff had increased by 30% in comparison to the year before. When comparing these figures, it still has to be kept in mind, that the employment situation is greatly depending on other factors as well, and it can not be directly assumed, that the merger is the only factor leading to personnel reductions.

When comparing the geographical breakdown of the personnel, it can be clearly observed, that Nordea is emphasizing its strong presence in the Nordic countries. The breakdown is quite evenly divided among the four Nordic countries, even though the Danish influence stays relatively small at this point. The three other countries, Finland, Sweden and Norway, have almost unanimous headcount numbers. UBS, on the other hand, has build a strong presence in the European countries and in the United States and that indicates, that Asia and its emerging markets with a higher risk are left outside their geographic expansion.

Both of the merger cases have played a central role in the structural change, and reflect the pattern of the development of the financial market. The question of whether or not these mergers are a part of the present merger wave or are they in fact a new trend, is difficult to answer at this point. Considering Nordea's strategy to build a Nordic banking empire would indicate that the Nordea mergers have been a part of a merger wave. It has achieved an important and strong presence in all of the Nordic countries, which would mean that it has reached its goal. However, Nordea has stated an interest also in the Baltic countries, which would prolong the merger wave. The question is, does Nordea still have resources to continue its evasion and do the antitrust-authorities allow a higher concentration of the banking industry. According to Resende's (1999) and Kleinert's (2000) researches on mergers and acquisitions in general and Peter Staarup's, (CEO of Danske Bank, Helsingin Sanomat, 16.10.2001) statements, Nordea has most likely reached its merger peak and will continue its business in the present form. But, on the other hand, Attali, van Miert or Komansky (International Labour Organization 2000, 5) may be correct also, and Nordea may be one of the few large financial institutions left in a couple of years. In the light of the present happenings, it may be safe to assume, that financial institutions carry out a risk avert strategy and avoid large restructurings. In any case, the future of these companies is not at all clear and it depends on macroeconomic

issues as well as on the future views of the key managers, so that it is impossible to speculate the developments any further.

6 SUMMARY AND CONCLUSIONS

This research surveyed theories and case studies related to corporate mergers. The main purpose was to study and compare two separate merger cases on basis of a theoretical framework of the strategies and implications of mergers and acquisitions. The study focussed 1) primarily on a detailed analysis of the business unit development (strategic development) and 2) secondary on an analysis of the personnel development in two large financial organisations in Europe, namely Nordea and UBS.

The material being used for the case studies consisted mainly of the annual reports of the concerned companies and related newspaper articles. The theoretical framework was built after the data of the case studies was compiled and the main topics of the mergers had been clarified. This elucidated the choice of appropriate theories out of the incoherent cluster of merger-related literature.

The central findings of this study were of three main kinds. First and most important, the **strategic positioning** of UBS and Nordea are found to be different. Where Nordea pursues an access-based and needs-based positioning, UBS focuses on a variety-based and needs-based positioning. Nordea's strategic choices have manifested through its specialization in retail banking within a specific geographical range in the Nordic markets. UBS' choices, on the other hand, can be found in its specialization in wealthy clients and fulfilling their private banking needs.

The second finding concerns the **geographic reach** and **competitive position** of the banks. Nordea's geographic reach is defined to be the Nordic markets and its growth is a protective measure to secure the leading market position within this area. Its competitive position is ensured by its size; it can provide a sufficiently broad array of products for the Nordic companies as well as pose a threat for potential rivals. UBS' geographic reach is more or less global (not including Asia) and its competitive position is ensured by its geographic risk diversification, but also by its strategic fit of the array of products.

The third finding of the study involves the **personnel development**. Both companies pursued cost saving redundancies immediately after the mergers, but have since then increased their headcount as merger synergies have come to effect. The geographical breakdown of the personnel underlines the geographical strategies of the companies. UBS has pursued a geographical diversification, and its employee breakdown is quite evenly divided between Europe and USA. In Nordea's case, the geographical breakdown is evenly divided among Sweden, Finland and Norway. Denmark's contribution is less, but still a remarkable part of the total, thus supporting the presumption, that Nordea pursues a strong presence in all the four countries.

The interesting point of the outcomes of this study is, whether or not these organisations are in fact pursuing different strategies, or are they simply organisations in different stages of development. After all, UBS started off being a domestic bank, operating exclusively within the Swiss borders. It started to broaden its geographical reach within the last 50 years, during which time it has been able to build a significant position among the most influential banks worldwide. Whether or not Nordea is going to build a similar position for itself remains to be seen and it might be an interesting topic of additional research.

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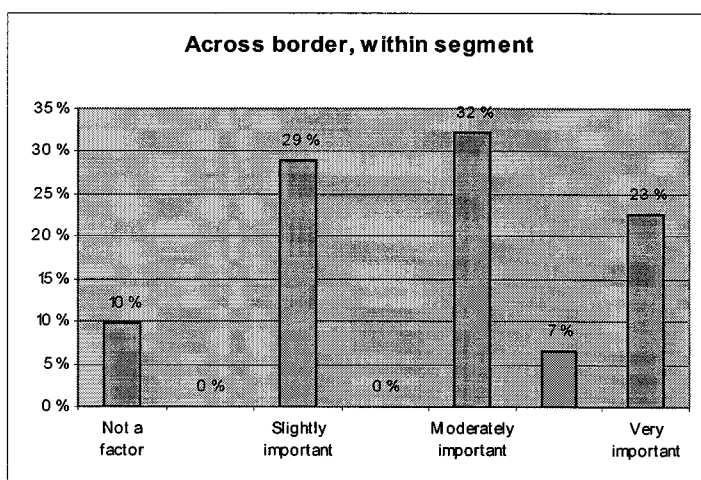
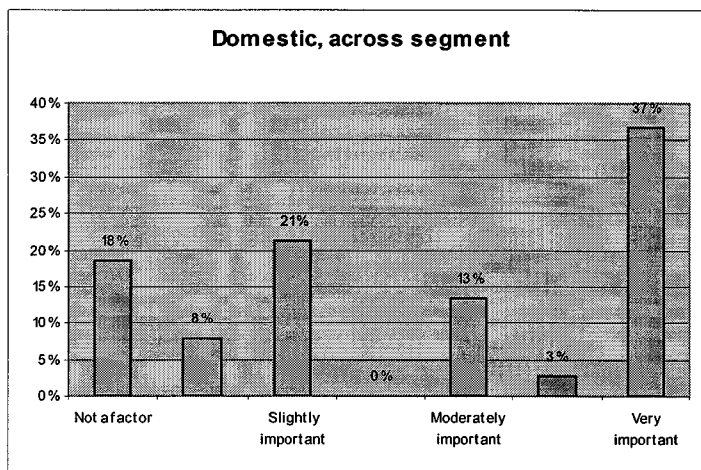
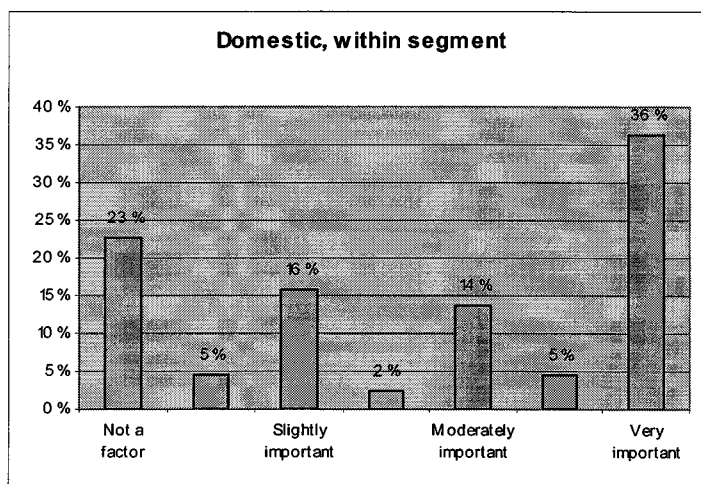
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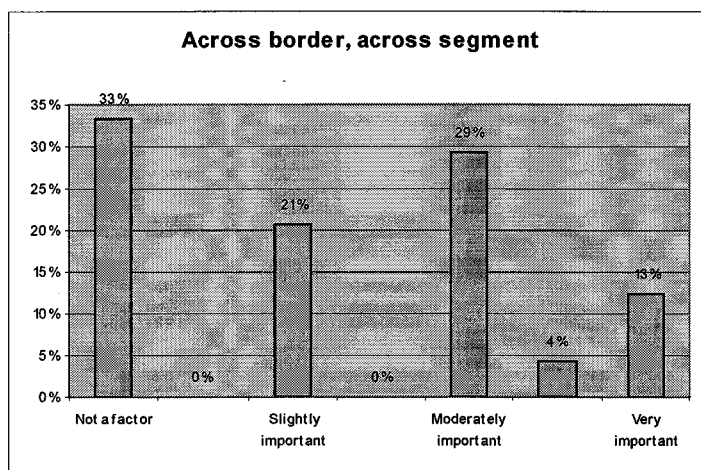
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APPENDIX 1

Deregulation as a motive for consolidation

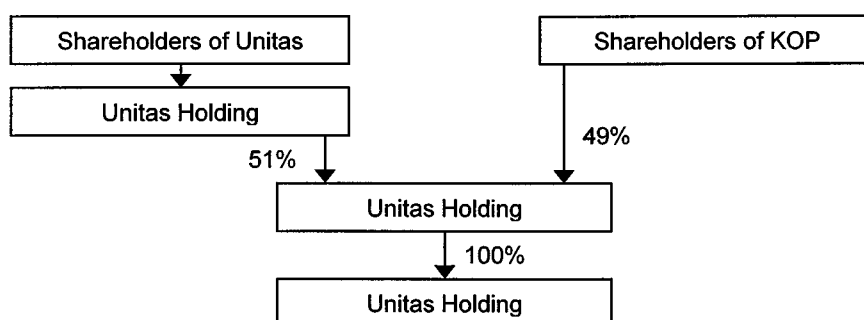




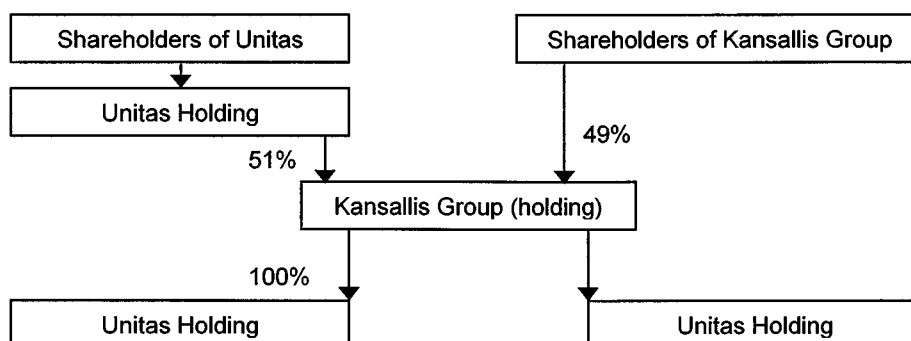
APPENDIX 2

Three stages of the KOP-UBF merger

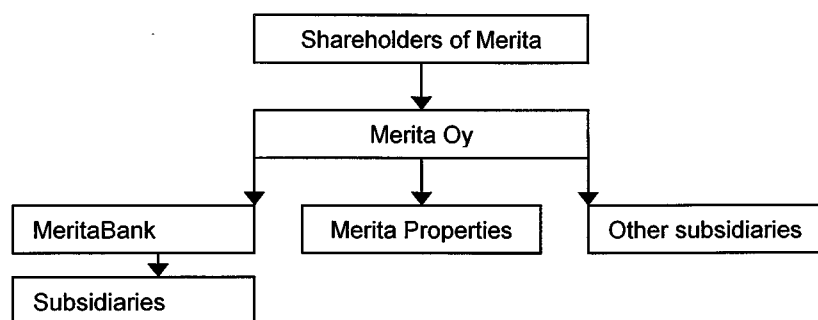
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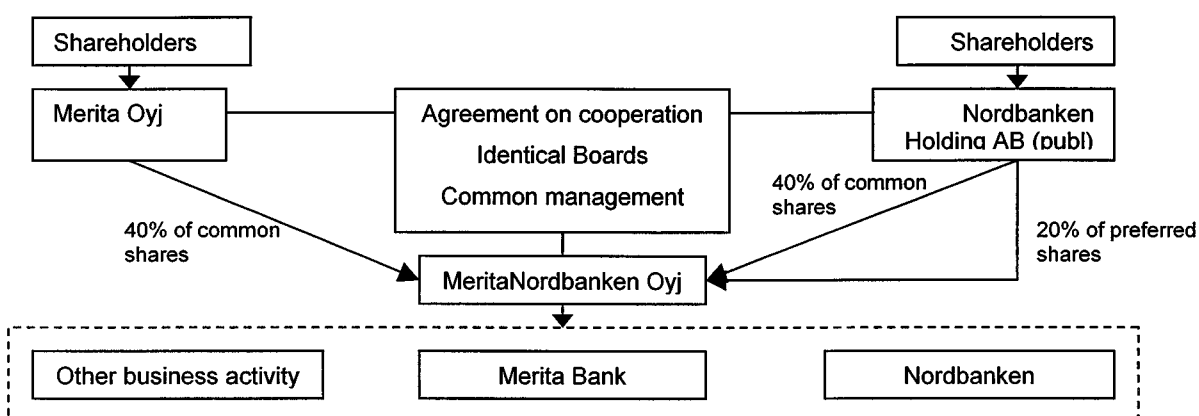
June, 1995



December 29th, 1995



MeritaNordbanken merger:



Final structure 2001:

