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Europe Banks Future on the Urge to Merge

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Santander Central Hispano successful purchased British lender Abbey National last year, and ABN Amro and Banco Bilbao Vizcaya Argentaria (BBVA) are now trying to break the domestic stronghold in Italy with respective bids on Banca Antonveneta and Banca Nationale del Lavoro (BNL). So has the long predicted moment for cross-border mergers finally arrived? Is a game of musical chairs in the retail banking sector about to begin?

Many forces are pushing the creation of larger banks. Competition in global markets, and in wholesale and investment banking, is increasingly tough. U.S. banks, no longer subject to legal or regulatory constraints, have understood this, and consolidation there is progressing rapidly. The fear that European banks will be targets for U.S. giants is motivating them to preemptively get together. The resurgence of activity in emerging economies, and the need to diversify, are also good reasons to merge.

And yet, despite frequent and intense speculation, cross-border transactions have been few and confined to the culturally and institutionally homogenous Nordic and Benelux countries. The reasons are well-known: Differences in culture and management style, limited scope for synergies, and the formidable regulatory obstacles erected by national governments to prevent foreign takeovers. Santander came up against protectionism in Portugal while attempting to acquire, eventually with success, the Champalimaud group. In France, Santander was kept out of the triangular battle between BNP, Societe General and Paribas, that ended up with the "French" solution of merging BNP with Paribas. Its Spanish competitor BBVA had a similar experience in trying to acquire Unicredito in Italy, as it now does in its attempt to get BNL.

Nonetheless, the strengthening of competition policy across the EU, and in the U.K. in particular, has encouraged banks with a limited freedom of maneuver in domestic markets to look for foreign partners. That's why Santander went after Abbey while other UK banks, fearful of antitrust intervention, were hesitant to bid. Any of the four larger British banks could have reaped more synergies by merging with Abbey, but the U.K. competition authorities, who blocked Lloyds TSB's earlier bid for Abbey in 2001, would have looked suspiciously at such a move.

Santander's bid was an opportunistic attack on a weak institution in a major European market. Its immediate rationale was to diversify Santander's international portfolio, concentrated in Latin America, especially Brazil. Santander targeted a British institution because the U.K. market is open to foreign acquirers, while France, Italy and Germany -- whose authorities wish to build national champions -- have erected numerous obstacles.

At first sight, it is surprising that a bank from inefficient southern Europe should move into the U.K., which has the most internationally competitive financial services sector in Europe. But this view of the Spanish industry is a caricature. Spain has been in the forefront of liberalization and competition in financial services. From the introduction of high yield checking accounts, to new mortgage productions, to consolidation and expansion in Latin America, Santander and BBVA have led the way.

The Spanish market has been an excellent school for competition and, consequently, for efficiency. Santander can use its experience to introduce international best practices at Abbey and reduce costs by introducing an integrated IT platform.

But the real test is now in Italy. The Governor of the Bank of Italy, Antonio Fazio, has clearly shown before that he does not favor foreign acquisitions in the Italian banking sector. His competition oversight powers, a residue of the past in Europe, have been confirmed recently and he has to approve any acquisition of more than 5% of shares in any Italian bank. But any direct opposition of the Bank of Italy to a foreign takeover should be based on the claim that ABN Amro or BBVA are a threat to the stability of the Italian financial system. This looks farfetched because those banks are well capitalized and supervised by their home country regulators. The European Commission would certainly have either competition or single market grounds to challenge any Italian attempt to stop the merger.

Unless Mr. Fazio's protectionist instincts prevail again, the gates will be open for the restructuring of the banking sector in continental Europe. For a start Italian consumers and firms will beneft. ABN Amro and BBVA most likely are better able, respectively, to run Antonveneta and BNL than any Italian consortium.

In opening its market, in eschewing national champions and in allowing foreign acquisitions, the U.K. has shown the right path for the development of retail financial services in Europe. By letting the market decide, Britain will end up ahead. Will European banking remain fragmented or follow its example? Will consolidation be confined to a few small domestic acquisitions? Or, will the imperative to consolidate across Europe be allowed to operate? In continental Europe, competition authorities, at national and European level, have a crucial role to play to remove artificial obstacles to consolidation.

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