Mergers of abbey national and santander finance essay

As Watson & Head (2007: 310-311) explained the terms ‘ Merger’ and ‘ Acquisition are used interchangeably but the differences are quite noticeable. The term ‘ Merger’ suggests the friendly reorganisations of assets into a new organization; the two similar sized organizations will then become one entity with both sets of existing shareholders. On the other hand, ‘ Acquisition’ or a Takeover suggests obtaining one’s company’s ordinary share capital by another one. In an acquisition the one of the organizations is larger in size and financial stability and has the dominant power over the other one. The ‘ Acquisition’ process is lengthy and very complicated in nature. Acquisition of any particular organization can have several motives, the acquirer may want to amplify their economies of scale, market share or to attain the financial synergy through declining the company’s cost of capital. All these can be classified as:

Horizontal Merger and Acquisition: Involves companies at the same stage of production in the same industry. i. e.: the acquisition of Cadbury by Kraft in 2010

Vertical Merger and Acquisition: This involves companies at different stage of production but within the same industry. The vertical integration can either be:

Forward movement towards the production process, i. e: A furniture manufacturer merging with a retail furniture outlet.

Backward movement towards securing the suppliers, i. e: A furniture manufacturer merging with a wood supplier.

Conglomerate Merger and Acquisition: involves companies in unrelated business lines. i. e.: A clothing company acquiring a jewellery company.

Trends in M&A activity 2004 to 2010 in Europe Banking Industry:

Figure 1: One in Five companies plans to go for large scale Acquisition in 2010 & some industries expect to be even more active. Source: USB and BCG CEO/Senior Management M&A survey- 2009 on 166 European Companies.

As from the Figure: 1 and Graph: 1 , The M&A trend in Retail and Insurance industries are in inclining nature, but we can observe an inclining trend in the Banking industry M&A in Western Europe compared to the global trend. The Western Europe Banking sector M&A shows a parallel movement with the global M&A trend, suggesting that the Western Market is very susceptible to the overall market movement. The inclining nature of the M&A in the Western Baking Sector (from mid 2005- mid 2009) suggests the upturn of the M&A trend in the during the current recession crisis, the banks were making profits with the global trends in M&A; as these banks are also earning fees from their advisory and other services, such as; syndicated banking facilities to support leveraged bids. The trend also suggests the wave of cross-border M&A with the movement of the global trend in order to expand the business.

Graph 1: Trend in Global M&A activity (2004-2010), compared to Eastern and Western Europe banking industry M&A. Source: Bloomberg

In the current recession years; with low interest rate, poor bond yields and high level of liquidity- the banking industry within the Western Europe is embracing the M&A opportunity as many corporations have pushed back the bidding deals.[1]

Table 1: M&A trend from 1/01/2010 to 29/03/2010. Source: Bloomberg

Acquirer Region	Target Region	Average Size (GBP million)
Global	Global	110. 63M
Global	North America	174. 94M
Global	Europe	79. 60M
Global	Asia Pacific	

65. 29M

Global

Latin America & Caribbean

331. 65M

Global

Middle East & Africa

106. 65M

North America

North America

159. 79M

North America

Europe

114. 29M

North America

Asia Pacific

48. 36M

North America

Latin America & Caribbean

47. 84M

North America

Middle East & Africa

17. 54M

Europe

North America

546. 90M

Europe

Europe

65. 42M

Europe

Asia Pacific

636. 53M

Europe

Latin America & Caribbean

1. 14B

Europe

Middle East & Africa

95. 87M

Asia Pacific

North America

128. 86M

Asia Pacific

Europe

41. 68M

Asia Pacific

Asia Pacific

46. 56M

Asia Pacific

Latin America & Caribbean

180. 35M

Asia Pacific

Middle East & Africa

94. 18M

Latin America & Caribbean

North America

183. 26M

Latin America & Caribbean

Europe

455. 35M

Latin America & Caribbean

Asia Pacific

73. 86M

Latin America & Caribbean

Latin America & Caribbean

506. 03M

Latin America & Caribbean

Middle East & Africa

11. 21M

Middle East & Africa

North America

10. 50M

Middle East & Africa

Europe

485. 98M

Middle East & Africa

Asia Pacific

21. 17M

Middle East & Africa

Latin America & Caribbean

7. 62M

Middle East & Africa

Middle East & Africa

134. 77M

From the table above, the M&A trend is inclining more towards emerging markets as the target regions; although, emerging markets are also opting for M&A activities in the same or different emerging markets to expand the business.

An Acquisition CASE: Abbey national PLC acquired by Banco Santander SA:

Background of Abbey National PLC:

The Abbey National Building Society was formed following the merger of the Abbey Road Building Society and the National Building Society in 1944[2]. In July 1989, Abbey became a public limited company and floated on the London Stock Exchange. With 12 million customers and assets of £ 177 billion, it is ranked the sixth largest bank in the UK by assets and the fifth largest by deposits (with a 9% share of the market). Reflecting its origins as a building society, it is the second largest mortgage provider in the UK, with an 11% share of the market. Furthermore, with 15% of the market, at the time of acquisition, it was the third largest provider of insurance protection products and has a large distribution network with more than 700 branches (EMCC, 2008). Abbey had two main business divisions, Personal Financial Services and the Portfolio Business Unit.

Background of Banco Santander Central Hispano SA:

Santander is a bank that has transformed itself: from being a middle player in the Spanish banking market 20 years ago, it is now a major global bank operating in Spain, Portugal, Germany, the United Kingdom and other European countries, as well as in Latin America. The group is currently the leading consumer bank in Europe and has over 10, 500 branches globally (excluding those branches gained through the acquisition of Banco Real as a result of a deal with ABN AMRO). Santander is a technologically advanced bank, with an information technology platform that is regarded as a strong competitive advantage. Excluding Banco Real employees, the group currently employs approximately 130, 000 people worldwide, of whom 50% are working in Latin America. There are also large numbers of employees working in the UK and Spain. (EMCC, 2008).

Banco Santander was a small retail bank when it started its business in 1985, since then it initiated its local market growth through mergers and strategic alliances; and later implemented Low-scale cross-border expansion through strategic alliances and acquisitions. Gradually, the implementation of Large-scale cross border expansion took place.

Chart 1: Banco Santander Acquisition Transaction Overview till January 2010. Source: Reuters

Overview of the Acquisition:

The objectivity of this particular acquisition/takeover was to diversify the business of Banco Santander PLC to mortgage and financial services; not to mention to explore the retail banking opportunities in the UK market. Therefore, the motive for this M&A was to gain economies of scale through synergy and also to entering a new market in order to optimize their market share, hence; buying Abbey was a mean to enter into Europe’s second largest consumer financing market. In 2003 Abbey National PLC was pricey for Santander and in 2004, Abbey incurred losses from its entry into the money market and Santander decided to go ahead with the ‘ Acquisition’ plan in order to penetrate the UK market.

Moreover, the secondary objective of this acquisition was to under-cut the local competition for Banco Santander with the hopes of obtaining higher profitability in the UK market. Moreover, Banco Santander already had the expertise in the retail banking and built a strategic alliance with the Royal Bank of Scotland from 1988. Therefore, Santander had already gathered banking knowledge and futuristic opportunities. As stated by Parada et al., (2009: 666-667) Acquiring Abbey National PLC would make Banco Santander the biggest bank in Europe and Latin America and dominating their business in the strong currencies- the Euro, US dollar and the Pound. The acquisition had boosted the company's operation in six segments: Retail Banking, Global Banking & Markets, Corporate Banking, Private Banking, Group Infrastructure and Sold Life Businesses. After the acquisition Abbey National PLC became Santander UK PLC in January 2010.[3]

" Abbey's leadership position in the United Kingdom's mortgage lending market, together with its extensive branch network, represent for the shareholders of Banco Santander and of Abbey an opportunity to create value based on the application of the best business and technological practices of Banco Santander to Abbey's banking operations. Abbey's business heavily contributes to reinforce our pan-European franchise and provides the Group with a more balanced earnings stream."-(Emilio Botín, Chairman of Banco Santander, July 2004).[4]

Table 2: Overview of the Abbey National PLC acquisition. Source: Reuters

As noted in Parada et al., (2009, 666-668) – in 2004 Abbey was suffering from losses from entering in the whole-sale money market; therefore, Santander grabbed the opportunity to launch a friendly bid. Santander managed to overpower all the regulatory obstacles. Although the acquisition was initiated in 2004; but the tentative completion of this acquisition is expected to be at the end of 2010; given Abbey National PLC will be renamed as ‘ Santander UK PLC’.

Figure 2: The 3 steps of internationalization implemented by Santander in 2004. Source: Authors.

Acquisition of Abbey National PLC

Graph 2: The dimensions of Santander acquisition with its growth (2000 to 2004). Source: Bloomberg

The graph above portrays the rising nature of Santander Share price after the Abbey acquisition at the end of year 2004.

Defence Strategy implemented by Abbey National PLC:

During the Acquisition offer, Abbey National PLC urged its rivals British banks to make counter-bid offer in order to push back the £8. 9 billion offer made by Banco Santander. Moreover Abbey spent out £9 million worth of Legal documentation to its approximately 1. 8 million shareholders in the hopes of bouncing off the Acquisition offer made by Banco Santander.[5]

Valuation of the Acquisition:

The asking price for the acquisition was £10 billion and the sold price was £8. 9 billion. The terms of the Acquisition were based on the equity market capitalisation of the two companies over the three months prior to 23 July 2004. Based on the average closing market price for a Banco Santander Share on the Spanish stock market was €8. 70 and the average closing mid-market price for an Abbey Share on the London Stock Exchange was £4. 69

at an exchange rate of €1. 5054: £1, the terms of the represent a premium of approximately 28. 4 % with a value of each Abbey Share at £6. 03 or 603 pence (taking into account the 6 pence for dividend differential, see the financing section), and the entire issued ordinary share capital of Abbey at approximately £8. 9 billion.[6]

Financing the Acquisition Bid:

The acquisition was finance through the purchase of Abbey shares and Mixed Bid offer was initially offered to precede the acquisition; where, Santander (the largest bank in North American and Spain) offered one of its own shares and 31 pence in cash for each share of London-based Abbey shareholders. [7]The special dividend of 25 pence will be paid along with 6 pence (31 pence in total) worth dividend differential to compensate the Abbey National shareholders; as historically the dividend payment of Banco Santander was usually lower than Abbey National Dividend payment (Table: 3). Later on, in November 2004, the acquisition was carried out through an exchange of one new Santander Share for each of Abbey share.

94. 6% backing support (based on the share counting only 64. 8 % shareholders agreed to the acquisition deal) was received from the Abbey's shareholders in order to proceed with the takeover. The deal was worth almost £9 billion (or € 13. 5 billion to be exact; at the time of acquisition offer the exchange rate was €1. 5054 to £1). The enlarged company would be 76%-owned by existing Santander shareholders, with the rest in the hands of Abbey shareholders.[8]

Regulatory Framework:

The acquisition took place under section 425 of UK Companies Act 1985. Moreover, Santander had to provide many paper-works and detailed plans to the European Authorities regarding the Abbey Acquisition (See Appendix, Illustration: 2). As a result of the acquisition, Abbey's remaining private shareholders became entitled to one Santander share and the shares are traded in Euros in the Madrid Stock Exchange.[9]

Table 3: Capital Value estimated for the Abbey Shareholders, Source: http://www. vernimmen. com/ftp/sch-abbey. pdf

Cultural Differences:

Although, the Spanish culture and British culture vary in many ways they run business. In British Culture, organizations rely mainly on their Human Resource, whereas, Spanish Culture relies more on the technological upgrading. Abbey National PLC had about 33% back-office employees; whereas, Santander had about 6% to 10% employees as back-end personnel. Therefore, after the acquisition the employee number in Santander PLC came down to 16 thousands from 24 thousands in the UK. At the time of acquisition Santander's cost to income was 42%, whereas in UK it was on about 50% or more.[10]

The acquisition may be affected by different tax incentives and regulations. Any change in the Spanish Banking policy will affect the Santander UK subsidiary both economically and financially. Moreover at the time of acquisition in 2004, the UK national savings rate is only 14. 7% of GDP, compared with over 23% in Spain. Therefore, the spending and saving nature in the UK are very diverse than in Spain.

As quoted in the Guardian (2005): " Santander .. treats its Spanish shareholders to an unusually attractive range of perks, from discounted medical insurance and dental care to cut-price hams and crates of wine."[11]. Therefore, such treatments in the UK can be perceived as manipulative technique due to the variance in these two cultures.

Performance in Share Price and Stock Market- Post Acquisition:

Since Banco Santander is a Spanish bank, the shares was listed in Spanish Stock Market and the shareholders had to face exchange rate volatility since the dividend were being paid in Euros; nonetheless, the Spanish taxation issue can be quite complicated to the UK shareholders. The Abbey shareholders were given the option to sell the shares to any Spanish Organization in the UK, but Abbey shareholders who held on to their Santander shares over time have to pay tax on any dividends they get.[12]Banco Santander new shares after the acquisition were not admitted to the Official List or to trading on the London Stock Exchange during the post period of the acquisition.[13]

In 2009 Santander 1. 1 million new current accounts with our 25 million customers, and reported to deliver more than 30% profit in five successive years after the acquisition.

Chart 2: The Overview of UK Competitors. Source: H1 '09 Reports Data and BBA Abstract by HSBC

Graph 3: Santander UK PLC share price performance. Source:

http://www. h-l. co. uk/shares/shares-search-results/s/santander-uk-plc–10-38-non-cum-stlg-pre/charts

The Santander UK PLC is in the second place after Lloyds Banking Group in the Mortgage market share in UK with relatively reasonable Market share in Retail Banking (Chart: 2). Moreover, The EPS of Banco Santander has been performing quite poorly after 2005, it has declined from 0. 337 in 2005 to 0. 27 in 2009 (See Appendix, Illustration: 3).

The share price of Santander UK PLC has been rising from the year 2005 (Graph: 3), partly because the dividend was 15% higher than that paid in the mid of the year 2005. As of in 2006, 25% higher dividend was paid. In 2008, Banco Santander announced its agreement to take over Alliance & Leicester PLC (A&L). Under the terms of the agreement Banco Santander will offer one Company share for every three A&L shares. The European Commission had approved Banco Santander £1. 3 billion takeover of Alliance & Leicester Plc. Moreover, in year 2008, Banco Santander had agreed to buy Bradford & Bingley PLC retail deposits and branch network. Santander had agreed to pay about £400 million to acquire 2. 7 million Bradford & Bingley customer savings accounts containing some £21 billion of deposits. Therefore, Santander UK PLC is still at its growth stage in the UK Market and it is focusing more on acquiring local financial institutions.

Reuters reported in October 2009 that, Banco Santander SA planes to maintain its policy of paying half its net profit in dividends in 2010. Moreover, according to the Yahoo Finance (April, 2010), Banco Santander SA has higher Dividend yield of 6. 80 % and global Foreign Money Centre Banks Industry has the rate at 1. 96%, which suggest a favourable investment option to the potential shareholders. The Santander Group is working towards the policy of maximizing shareholders profit.

Moreover, as reported in Bloomberg, Banco Santander SA is seeking to list its UK business in London Stock Exchange listing from February 2010 in order to raise funds for possible future buy-up opportunities, the listing offering may value at more than £15 billion. Banco Santander is looking for funds to bid for Royal Bank of Scotland PLC network of 300 branches.

On the other hand, Santander UK is willing to sell 25% of its stake in order to be listed in FTSE 100 and also to pay out about £1 billion a year in dividends to construe an attractive deal to the investors (Source: The Times).

Conclusion:

Although, there were many speculation against the Abbey acquisition due to its cross-border nature, but all the speculations were proven wrong. Although, this particular acquisition was the most talked about topic in the UK financial market, and many believed the acquisition would not create any value for the Abbey Shareholders. With proper understanding of the local market, Banco Santander had utilized its previous acquisition knowledge when it came to this acquisition. Banco Santander knows what its UK shareholders want and trying to live up that expectation to serve their UK shareholders. Banco Santander is seeking to expand its business in the UK. Although, till date the Abbey bank transformation is still under progress, but

Banco Santander had been patient with the UK market because they know- ‘ slow and steady wins the race’.

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