The Importance of Mergers & Acquisitions within the Danish banking sector during a financial crisis

Bachelor Thesis

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Executive Summary

The world is globally affected by the financial crisis due to subprime mortgages in the US causing banking sectors around the world to suffer. Around the world banks have collapsed and governments have been compelled to provide financial rescue packages to secure financial stability.

The financial crisis has had a great influence on the level of bank mergers and acquisitions (M&A). The purpose of the study is to investigate and analyse the importance of M&A within the Danish banking sector during a financial crisis. The study will mainly concentrate on M&A of Danish banks and the factors causing banks to engage in M&A during a financial crisis. Furthermore the study investigates the factors leading to the financial crisis in Denmark as well as motives for banks to engage in M&A.

The study has been carried out as a desk research with a theoretical approach.

The paper refers to a number of different key issues within the banking sector and the way banks have been managed in recent years. The study shows how the Danish banking sector has been influenced by the global financial crisis, as well as the national problems Danish banks are facing. It also looks at the motives and incentives for managers to engage in M&A as well as the disadvantages caused by this activity. It is argued that Denmark is experiencing a Danish financial crisis, instead of a crisis only dependent on the global financial crisis. The Danish banking sector has thereby been affected by both global, as well as national factors. The study will investigate whether this has had an influence on the level of M&A within Danish banks compared to Europe and the US. Furthermore the study analyses whether a difference in M&A activity within Danish sectors occurred during the financial crisis, as well as causes for these differences. At the end, the study will discuss the engagement of Finansiel Stabilitet in the banking sector. Hereunder issues including financial stability, free market competition, as well as the Danish state as a bank owner will be discussed.

The findings of the study show that national problems due to mismanagement of banks, including running a risky business with high lending, have had a great influence on the Danish banking sector and the country's financial stability. A lack of appropriate behaviour within the banking sector has resulted in a frozen interbank market, which to a great extent has had a huge effect on the sector's further development. This has resulted in situations where banks had to face the problems of insolvency and bankruptcy.

Furthermore, the findings of the study show that Danish banks have experienced a larger volume of bank M&A activity, adjusted by population size, than the US and Europe. This is a result of the different problems within the different banking sectors. Also, the study shows that Danish bank M&A have been different from other Danish sectors. While the banking sector experiences an increase in M&A during the financial crisis, other sectors have experienced a decrease, which mainly is caused by their
inability to obtain bank loans to finance the activity. Lastly the findings show that M&A within the
Danish banking sector during the financial crisis have had a great importance due to banks ability to
survive. It has been a great way for healthy banks to survive the financial crisis in spite of the liquidity
and solvency problems they have been facing.
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1. Introduction

Today the world is globally affected by the largest financial crisis since the Great Depression in 1929. Economies around the world have collapsed, and this has affected almost everyone – both private persons and companies. In most countries financial stability has been a critical issue due to factors connected to the financial crisis (Ellemose, 2009).

During the global financial crisis there has been a great focus on financial institutions, which has become highly dominated by insecurity in the financial market. Financial institutions are suffering from huge deposit deficits, a frozen interbank market, and a lack of appropriate governance. In this connection Denmark has been affected by global as well as national problems. In order to cope with the situation the Danish state and Central Bank has introduced various initiatives (Bechmann, 2009).

Due to the financial crisis many banks have used mergers and acquisitions (M&A) as a strategic tool to handle the difficulties the situation has caused. This has been reflected in the development of M&A activity within the banking sector.

It has been discussed whether the banking sector gains any economic advantages from M&A. This has drawn focus to non-economic incentives. Managerial motives have been giving much attention in connection with the situation (Houston et al., 2001).

1.1. Problem Statement

During the financial crisis a sharp increase in M&A activity has appeared within the Danish banking sector (KPMG, 2009). In this connection it is relevant to investigate and evaluate whether the banking sector is dependent on M&A in order to make it through a financial crisis. It is interesting to look at the banking sector, since a country is highly dependent on its financial stability.

This leads to the following problem statement:

*What is the importance of mergers and acquisitions within the Danish banking sector during a financial crisis?*

1.2. Investigation Questions

In order to answer the problem statement investigation questions have been made. Not only is it relevant to look at M&A within Danish banks, but also to compare and evaluate whether the M&A activity in the Danish financial market has been showing significantly different signs than financial
markets in other parts of the world. Furthermore it is relevant to compare the banking sector to other sectors in order to find out what causes the differences within M&A activity.

The questions are based on hypothetical assumptions, which can have an influence on the result of the analysis.

- Why does M&A activity within the banking sector increase during a financial crisis?
- Which advantages and disadvantages are connected to M&A activity within the banking sector?
- Are Danish M&A within the banking sector different from rest of the world?
- Is it more important for banks to engage in M&A activity during a financial crisis than it is for other sectors?
- What effect has the financial crisis had on M&A activity?

### 1.3. Structure of the Report

The report is structured the following way:

![Figure 1.1. Structure of the Report.](image)

**Chapter 2 and 3** will cover the theoretical framework and background knowledge to create an overview necessary to continue the following analysis, and be followed by **chapter 4** which will give an insight to the problems the Danish banking sector is experiencing.

Chapter 5 and 6 will be of main importance when making the analysis of the report.

**Chapter 5** focuses on issues within the banking sector, which have attracted much attention during the financial crisis. It will give an overview of the problems Danish banks are experiencing.
Furthermore initiatives introduced by the government during the financial crisis will be explained shortly to obtain an understanding of the factors that have been affecting Danish banks.

**Chapter 6** focuses on interesting factors affecting M&A activity within the banking sector. This is done by evaluating advantages, disadvantages, and motivational factors to get an understanding of the factors influencing the decision to engage in M&A.

Chapter 7, 8, and 9 will be used to put the topic into perspective and thereby enable us to make a subjective conclusion.

**Chapter 7** compares the Danish, American, and European M&A activity within the banking sector. This analysis is made to get a picture whether the increase in M&A is common internationally or the development is exclusively a Danish phenomenon.

**Chapter 8** compares M&A activity within the Danish banking sector to other Danish sectors. This is necessary to find out whether M&A activity within the banking sector is similar to other sectors.

**Chapter 9** looks at the development of M&A activity within the banking sector before and during the financial crisis. This is done to find out if the financial crisis has had an effect on M&A activity.

**Chapter 10** will conclude whether M&A have an important influence on the Danish banking sector during a financial crisis.

### 1.4. Methodology

The study has been carried out as a desk research with a theoretical approach.

The theoretical framework will mostly be based on books, while news articles, chronicles, research papers, and company reports will cover the analysis. This choice of method has been chosen with reference to the opportunities regarding the choice of a contemporary subject.

The advantages of the chosen method are the updated material and insight to the problem as well as the contemporary relevance, which gives the opportunity to obtain opinions from many different angles. The drawback of this method is the lack of specific theory and literature regarding M&A within banking sectors during financial crises. In spite of this disadvantage this method is the optimal solution to cover the subject stated.
1.5. Scope and Delimitations

Zephyr will be used as statistical database. It limits the research to look at the period from 2000 to 2009, both years included, since it only contains a limited number of deals made before 2000. It is not a problem to limit the data to this time frame, since the data will only be used in chapter 7, 8, and 9. Here the main focus is to investigate the difference in M&A activity level within the banking sector in Denmark, the US, and Europe, as well as in different sectors in Denmark during the financial crisis. Additionally, Zephyr does not contain the total amount of deals. This has been concluded from a comparison with other sources (see appendix 12.1. for further clarification). In spite of the inaccuracies it is the best covering database in regard to M&A and has therefore been chosen. Though imperfections exist it is assumed that the use of this particular database will not change the overall picture of the development within M&A.

Collection of literature has occurred before April 22nd 2010, and the report will therefore not consider any literature published after this date.

We have chosen to limit our analysis to M&A within the Danish banking sector during the recent financial crisis to be able to make a thorough analysis. There will not be made a thorough analysis of banking sectors in other countries nor other sectors in Denmark. Information about these sectors will only be used to compare and get a true and fair view of M&A activity within Danish banks during the financial crisis.

This report will focus on a banks ability to use M&A to survive a financial crisis. Therefore, limited focus will be given to the financial situation of the shareholders. The main purpose of the report is to conclude whether bank M&A have a greater importance during a financial crisis, and therefore not a banks ability to create profit from M&A.

This report is mainly written to clarify the situation of the financial crisis within the banking sector in Denmark and their use of M&A. The report can therefore be used as a tool to get a better understanding and insight into the situation many Danish banks are experiencing.

1.6. Conceptual Clarification

Throughout the report mergers and acquisitions will be referred to as M&A. M&A activity will be used to describe both merger and acquisition activity, though most M&A activity constitutes of acquisitions (Hubbard, 2008) the terminology will still be used in regard to both mergers and acquisitions.
Furthermore it is important to understand, that even though M&A activity is used to describe both activities, mergers and acquisitions are not the same.

When mentioning Finansiel Stabilitet it refers to Finansiel Stabilitet A/S.

When mentioning the financial crisis in general it is the current financial crisis that is referred to. When talking about previous financial crises it will be clearly stated in the report.

Sources will be written in parentheses and be included in the text. In the bibliography the full name of the source will be stated including which abbreviation that covers the source.
2. Theory and Background Knowledge for Mergers and Acquisitions

The following chapter will describe the theoretical background of motivators for M&A as well as explain the reasons for increased M&A activity throughout history. This is done to give the reader a theoretical background that will be useful throughout the report.

2.1. Definitions of Mergers & Acquisitions

According to Straub (2007) the phrase M&A refers to the aspect of corporate strategy, corporate finance, and management dealing with the buying, selling, and the combination of another company that can aid, finance, or help a growing company in a given industry to grow rapidly without having to create another business entity. I.e. when a company engages in M&A activity and decides to acquire a target company it is making an investment. The general principle is that the acquiring company should go ahead with the acquisition if by doing so it creates a net contribution to shareholders wealth (Brealey et al., 2007).

In a merger two companies come together and create a new entity and the result is a legal dissolution of one of the companies, i.e. two companies agree to go forward as a single new company, rather than remaining separately owned and operated (Bragg, 2007, Grinblatt et al., 2006 & Straub, 2007).

In an acquisition a company, the acquirer, buys another company and manages it consistent with the acquirers needs (Bragg, 2007, Grinblatt et al., 2006 & Straub, 2007). According to Bragg (2007) the result of an acquisition is that both companies are left standing as separate entities at the end of the transaction. According to Grinblatt et al. (2006) and Straub (2007), the two companies do not have to be separate entities after the transaction, but can also be combined into one entity, which contradicts the definition of an acquisition made by Bragg (2007). Despite the disagreement between Grinblatt et al. (2006) and Straub (2007) regarding the companies position at the end of the transaction, they agree when one company takes over another company and clearly establishes itself as the new owner it is an acquisition (Bragg, 2007, Grinblatt, 2006 & Straub, 2007).
2.2. Theory of Motivational Factors for Mergers & Acquisitions

2.2.1. Types of Mergers & Acquisitions
According to Grinblatt et al. (2006) investment bankers often find it useful to define three different categories of M&A:

- Strategic acquisitions
- Financial acquisitions
- Conglomerate acquisitions

Strategic mergers (also classified as horizontal mergers) are ones that take place between two companies in the same line of business, which implies that the two companies are former competitors (Brealey et al., 2007 & Grinblatt et al., 2006). It is important to be aware that not all strategic mergers are legal and therefore some have been blocked by antitrust regulators (Brealey et al., 2007).

A strategic acquisition is one in which the acquiring company is able to gain operating synergies, which means that the two companies are more profitable combined than separate within operating areas (Grinblatt et al., 2006). As in the case of a strategic merger, the two companies are former competitors (Brealey et al., 2007 & Grinblatt et al., 2006).

Financial acquisitions are marked by no operating synergies. Instead companies engage in financial acquisitions because the acquirer believes that the target company is undervalued relative to its assets. Another motive for engaging in financial acquisitions is the tax gain sometimes associated with the acquisition.

In a conglomerate acquisition no clear potential for operating synergies exist, since the two companies operate in unrelated lines of business (Brealey et al., 2007 & Grinblatt et al., 2006). This type of acquisition is often motivated by financial synergies, which enables a company to lower cost of capital and thereby create value. The operations of the two companies do not benefit from the combination (Grinblatt et al., 2006).

The three types of M&A will be used to describe the different activity within M&A that has been seen throughout history.

2.2.2. Motives for Mergers & Acquisitions
Companies engage in M&A activity of different reasons in which strategic motives and efficiency gains are the most common factors (Gregoriou et al., 2007). Companies engage in strategically motivated
M&A transactions in order to reduce competition (Gregoriou et al., 2007), whereas companies engaging in M&A activity motivated by efficiency gains hope to profit from the combination by synergies (Brealey et al., 2007). According to Grinblatt et al. (2006) two types of synergies exist:

- Operating synergies
- Financial synergies

Operating synergies include among others economies of scale, economies of vertical integration, and the combining of complimentary resources.

Through economies of scale the management have the opportunity to spread fixed costs across a larger volume of output. The cost reduction comes from consolidation of operations as well as elimination of redundant costs. Economies of scale are often the main reason why companies engage in strategic acquisitions. Economies of scale have sometimes been the reason for engaging in conglomerate acquisitions as well. In conglomerate acquisitions economies of scale is gained through the sharing of central services, such as accounting, financial control, and top-level management (Brealey et al., 2007).

Through economies of vertical integration the management have the possibility of gaining control and coordination over the production process. This will eliminate various coordination and bargaining problems between customer and supplier. Economies of vertical integration are gained through backward or forward expansion (Brealey et al., 2007 & Grinblatt et al., 2006). In recent years vertical integration has not created economies of vertical integration, which is why many companies are now outsourcing instead (Brealey et al., 2007).

The combining of complementary resources requires that each company is in possession of a resource the other company needs. For both companies, engaging in the M&A activity is often a faster and cheaper way to gain access to needed resources, than by producing them itself (Brealey et al., 2007).

Financial synergies include among others diversification and mergers as a use for surplus funds. Through diversification the risk of the company's stock is decreased. Thus, the company's stock becomes more attractive for investors and a reduction of the company's cost of capital is often seen (Grinblatt et al., 2006).

Mergers as a use for surplus funds are motivating managers in companies with excess amount of cash, but few profitable investment opportunities. Thus they are able to increase capital by financing M&A by their excess amount of cash (Brealey et al., 2007). Besides the investment opportunity, personal taxes that otherwise have existed if the two companies had been trading partners, can be eliminated (Grinblatt et al., 2006).
These motivational factors will be used to explain the different incentives companies have had to engage in M&A activity throughout history.

2.3. History of Mergers & Acquisitions

Throughout the last century five waves of major M&A activity has occurred (Bruner, 2004 & Gregoriou et al., 2007), which has been motivated by large changes in macroeconomic factors (Bruner, 2004). When evaluating the five historical waves it can be obtained that similar and often equal macroeconomic factors have been the reason for many of the waves. In this part of the report the five historical waves of M&A activity will be described.

In the 1890s the first observed wave of M&A activity occurred. It is believed to have been generated by an economic depression, legislation governing incorporation, and the development of trading in industrial securities on the New York Stock Exchange (Gregoriou et al., 2007). The main goal to engage in M&A activity during the 1890s was to consolidate industrial production, and reduce competition among companies (Gregoriou et al., 2007). This is why most consolidations during the 1890s were characterized by strategic M&A in order to attain operating synergies. With limited competition in the market the different industries were facing monopolistic trends, caused by the many strategic M&A. Furthermore the economic depression of the 1890s, caused by railroad overbuilding and financing, forced some companies to engage in M&A activity in order to survive, whereas others engaged because of monopolistic reasoning to keep prices artificially high. In the US the M&A during the first wave created the principal steel-, telephone-, oil-, mining-, and railroad company and other large companies of the basic manufacturing and transportation industries (Lipton, 2006). The first M&A wave ended in 1905 (Gregoriou et al., 2007).

In the late 1910s and during the 1920s the second wave of M&A activity appeared. The M&A in this period were the result of a counterattack to the monopolistic structures that was created by the first wave (Gregoriou et al., 2007). Around 1910 antitrust legislation in both the US and Europe began to be enforced. As a result the only option companies had for growth was through vertical expansion, thus this wave has become known for its creation of oligopolistic structures (Gregoriou et al., 2007). During the second wave companies engaged in vertical M&A in order to obtain a strengthened supply chain. Ford, the car manufacturer, is a result of the M&A activity during the second wave (Lipton, 2006). The second wave of M&A activity came to an end in the late 1920s, caused by the Stock Market Crash of 1929 and the Great Depression of the 1930s. The Great Depression as well as World War II has been reasons for decades without remarkable M&A activity (Gregoriou et al., 2007).
The third M&A wave is said to take off during the 1950s and come to an end in 1973 as a result of the oil crisis and recession following the crisis. Many explanations for the rise of the third wave exist. Companies sought to diversify from competitors, and engaging in conglomerate mergers was the main choice, since stricter antitrust regulations during the 1960s often blocked for mergers within the same line of business. Furthermore less well-developed external capital markets and labour inefficiencies, as well as a sequence of economic, social, and technological changes can be seen as reasons for a boom in M&A activity during the 1950s and 1960s (Gregoriou et al., 2007).

In 1980 the fourth wave of M&A activity emerged as a result of inefficiencies created by companies who sought diversification, as well as loosened antitrust regulations, increased competition in capital markets, and improved shareholder control. During the fourth wave companies started refocusing on core business ideals as well as began to see the benefits obtained by not trying to diversify (Gregoriou et al., 2007). Furthermore the fourth wave saw a new trend in hostile bidders, who were always interested in picking of slower, less efficient firms (Gregoriou et al., 2007). The first hostile bid in the US was made by Morgan Stanley on behalf of Inco Ltd. seeking to take over ESB Inc. This successful hostile bid by Morgan Stanley opened the doors for major investment banks to make hostile bids on behalf of raiders (Lipton, 2006).

In Europe the last part of the 1980s was characterised by cross-border strategic mergers preparing for the Common Market. Companies engaged in cross-border strategic mergers in order to be competitive after the elimination of tariffs and trade barriers (Lipton, 2006). The fourth wave of M&A activity ended in 1989 (Gregoriou et al., 2007).

The fifth wave of M&A activity had its offspring in 1993 along an economic bull market (Gregoriou et al., 2007). The activity level and characteristics of M&A during the fifth wave was remarkably different from the fourth wave. First of all the activity level during the fifth wave was much larger caused by lower interest rates and easier credit terms. Secondly the European M&A market was as large as the American, and thirdly a substantial takeover market in Asia emerged. Furthermore many M&A

1 Inco Ltd.: Canadian nickel company (The Canadian Encyclopedia, 2010)

2 ESB Inc.: American battery company (Geisst, 2004)

3 Raiders: An individual or company attempting to acquire enough equity in a target company to assume a controlling interest, which allows the raider to replace the existing management with his own representatives, and thereby completing the takeover (Investorwords.com, 2010a).

4 Bull market: A prolonged period in which investment prices rise faster than their historical average (Investorwords.com, 2010b).
conducted during the fifth wave were cross-border transactions, which reflect the increase in capital market globalization in the 1990s. The fifth wave of M&A activity ended in 2000 as a result of the equity market downturn that year (Gregoriou et al., 2007).

Some theorists are starting to talk about a sixth wave of M&A activity which is said to have started in 2003, but since no conclusions can be drawn about the drivers of this sixth wave, it will be left out in this report.

2.4. Common Factors for the Five Waves
In order to understand why M&A waves have evolved over time it is important to notice that a low or falling interest rate, a rising stock market, and an expanding economy has been common factors for all five historical M&A waves (Bruner, 2004). Furthermore an understanding of why these factors have been common and how they have triggered a higher M&A activity throughout history can be necessary in order to understand the economic reasoning behind M&A waves.

Firstly, a low or falling interest rate often increase the level of M&A activity, since companies are able to borrow money to finance M&A activity at a cheaper cost. This has been a remarkable advantage, since the financing of the activity has been cheaper for the firm in a long run perspective (Bruner, 2004).

Secondly, a rising stock market has often especially increased acquisition activity, since the acquisitions in these periods are primarily financed through a stock acquisition. Since the acquiring company knows that its own stocks are overvalued, it often assumes that they are more overvalued than the target firm, and thereby believes that it makes a good deal (Bruner, 2004).

Thirdly, an expanding economy has been a driving factor for M&A activity, since managers often view the future more positively than in an economic downturn. As well as it often becomes easier for them to get an overview of advantages and possibilities of target companies (Bruner, 2004).

Besides the three factors already mentioned, it can be obtained that M&A activity appears to slow down when the cost of capital increases as measured by real interest rates (Bruner, 2004). This is simply because, as the cost of capital increases, firms will have to pay more for the same capital investment.
3. The Financial Crisis

The following chapter will give an introduction to the financial crisis to provide an overview of the subject. This is done to be able to get an understanding of the factors leading to the development within M&A.

During a period of low nominal interest rates, low financial market volatility, decreasing lending standards, and rising house prices an almost inevitable financial crisis arose beginning in the US in 2007 (Plesner, 2008 & Kodres, 2008). A financial crisis, originating from an overexploited subprime market in the US, has further on developed to a global financial crisis (Grosen, 2008a). The International Monetary Fund has in its 2008 Global Financial Stability Report estimated the total global loss caused by the global financial crisis to $945 billion including losses within areas such as commercial real estate (Dodd, 2008). Much focus has been given the global financial crisis, but national problems give reason to discuss a Danish financial crisis.

3.1. Introduction to the subprime crisis

The global financial crisis mainly originates from the subprime crisis in the US (Grosen, 2008a). Subprime mortgage lending was before 2000 mainly used as a second mortgage, but a greedy market of subprime mortgage lenders developed the market to reach much further (Hull, 2009). A subprime mortgage is defined by carrying a significant greater risk than an average mortgage (Hull, 2009). An applicant applying for a subprime mortgage will therefore represent a greater risk, and subsequently pay a larger interest rate to compensate for the risk.

Beginning around year 2000, mortgage lenders started to relax their lending standards opening up for a new market segment. This made it possible for more people to qualify for a loan. People, who was never considered for a loan, was now able to apply for a mortgage and become house owners. Lowering standards increased the customer area and subprime mortgage lending increased significantly during 2000 to 2006 (Hull 2009).

As an effect of the increasing expansion in demand on the American real estate market, house prices
kept increasing. This increasing demand leading to higher house prices was very attractive to the lender. Higher house prices meant improved and stronger collateral for the borrower making the mortgage less risky for the lender. Meanwhile it became even more difficult for first-time buyers to afford a house. In this connection lending standards were relaxed even more and adjustable rate mortgages were introduced to exploit the market even further. Adjustable rate mortgages were characterized by teaser rates. A teaser rate is an introductory interest rate, which was created to attract customers, and to make more individuals able to qualify for a loan. For the first two or three years the interest rate would be extremely low followed by a sharply increased interest rate when the teaser period came to an end (Hull, 2009). At the time of applying most applicants would not be able to qualify for the higher interest rate following the low teaser rate, neither be able to afford a regular mortgage. In spite of this, applicants were still accepted due to prospect expectations of increasing house prices. Increased house prices would result in an increased collateral in the house, thereby making the applicant better qualified for the mortgage. This meant that applicants were assumed to be accepted for re-financing (Dodd, 2008).

Like first-time house owners took advantage of their increasing house equity to afford their mortgage, other people also exploited the development of the real estate market. People invested in real estate with the future prospect of increasing house prices. Investments in real estate were attractive due to the drastic rising house prices combined with low interest rates. Increasing house prices with a low cost on interest rates made the value of the investment greater than the fees and expenses it would cost to finance a mortgage (Soros, 2008 & Kodres, 2008).

Additionally, financial institutions made risky investments based on the expansion in real estate. Increased gearing dominated the picture of many banks. Lending rates were sky high and huge deposit deficits were created. Most deposit deficits were financed with external sources, which became a problem when the crisis struck. A frozen interbank market resulted in many bankruptcies from banks, which were no longer able to finance their difference in lending and deposits (Ellemose, 2009).

### 3.2. Securitization

For many years securitization has been widely used within financial markets as an important tool (Hull, 2009). Securitization is a way of transforming financial products by making packages consisting of different risks. Various debt instruments are pooled to create products containing different risks and yields. New securities backed by the pool are thereby created to meet the demand of investors (Davidson, 2003 & Ellemose, 2009). The originators of mortgages simply find a second part, like insurance companies, pension funds, or hedge funds, to fund the mortgages (Kodres, 2008). The
American government has since the 1990s strived to expand American home ownership. This has partly been done by pressuring lenders to accept loans to people in the group of low and moderate income. This position has given lenders the opportunity and incentive to exploit the market increasingly (Hull, 2009).

Before 2007 a model called originate-to-distribute was widely used by banks. This model had great influence on the development leading to the subprime crisis. The originate-to-distribute model had a greater focus on whether the mortgage was profitable and sellable almost excluding considerations whether the applicant for the mortgage was creditworthy (Hull, 2009). The originate-to-distribute model was effective because banks this way was able to finance an aggressive lending growth without necessarily having to increase growth in deposits. Furthermore, this kind of financing avoided rules and regulations regarding capital needs (Plesner, 2008). By using this model the originators avoided taking any risk when the period leading to the crisis was at its top, which characterized their way of evaluating mortgage potentials (Kodres, 2008). A mixture of low lending standards, teaser rates, and lenders applying the model of originate-to-distribute resulted in individuals getting accepted for a mortgage, which they were not actually qualified for. This was the result of manipulated and ignored facts. The mortgage applicants were mainly evaluated on the background of their FICO-score and value-to-loan ratio (Hull, 2009). No other information was investigated since this was the only relevant information needed when selling the mortgage to others. Both FICO-scores and loan-to-value ratios were often manipulated to make the applicants seem more qualified than they actually were. FICO-scores could be improved by making regular repayments on credit card debt for a certain period and loan-to-value ratios was often improved due to a pressure from the lender (Hull, 2009) Loans were therefore created on a false or manipulated background search to make money on people who could not actually afford a mortgage, and who was unlikely to be able to repay the debt, therefore making the mortgage very risky.

The subprime mortgages, accepted due to low lending standards during 2000 to 2006, have created new terms. Two well-known expressions are liar loans and NINJA loans. Liar loans have been given its name because the applicants applying for these loans were lying to get their mortgage approved. They were able to do this due to the lack of background checks of personal information like applicant’s income, how long the applicant has been living at his current address and so on. NINJA loans described

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5 Originate-to-distribute model: Based on the idea that a mortgage is accepted to be resold (Kodres, 2008).

6 The FICO-score is a credit score evaluating a borrower’s ability to repay a loan (myFICO, 2009)

7 Value-to-loan ratio expresses the value of the loan compared to the value of, in most cases, the property (Property-Investing.org, 2010).
mortgages given to individuals with No Income, No Job, no Assets (Hull, 2009; Kodres, 2008 & Dodd, 2008).

The investment funds never doubted the work of the agencies rating the mortgage applicants. Thus they never paid any particular interest to the products they had bought, since they expected to be able to resell the securities if needed. One mistake was to fully trust the agencies another was to overestimate the importance of the ratings and thereby exclude any further documentation of the applicant and product to make sure it had sufficient collateral and was qualified (Kodres, 2008).

3.3. Asset-backed securities

As the subprime market developed mortgage lenders became more and more creative, developing new products created from the many subprime mortgages. Highly structured credit products were created to meet the demand of high-yielding securities, referred to as AAA-rated securities, resulting in loans, which became of a lower and lower quality (Kodres, 2008). Pools of mortgages were made and the main security was asset-backed securities (see figure 3.1. & Hull, 2009).

An asset-backed security is a financial security whose value and income payments are calculated from a specific pool of assets. Likewise is the collateral. The securities can be backed by different types of assets most common being auto loans, student loans, credit card receivables and home equities (Agarwal, 2010). Asset-backed securities were created to manipulate the attractiveness of the loans. By implementing the asset-backed securities it was possible to make different classifications and thereby making some parts more attractive than others (Davidson, 2003).

![Figure 3.1. Asset-backed Security](image)

The originator of the assets sold the assets in tranches to make securities with different risks and yields. They were divided into senior tranches, mezzanine tranches and equity tranches. The cash flow
of the assets would be divided between the three tranches with the senior tranche carrying the least risk, but also the lowest yield, and the equity tranche carrying the highest yield, but also the highest risk. These two tranches were the most interesting and sellable securities (Hull, 2009). This way, originators were able to fulfil the demand of AAA-rated securities. The incoming cash flows were divided into the different tranches justifying a classification of AAA (Kodres, 2008).

3.4. Risk Management, Wholesale- and Short-term Funding

Different factors seem to have worsened the situation of the global financial crisis. Most important are the lack of proper risk management and the increased use of wholesale and short-term funding. (Kodres, 2008)

In the period leading to the financial crisis has had a lack of appropriate risk management. The different rates relevant include credit risk, market risk, and liquidity risk (see figure 3.2.). Credit risk indicates whether a borrower will be able to repay a loan, thus stating the actual risk of default (Kodres, 2008). Market risk includes the effect of other market conditions, which can affect the ability to fulfil obligations. Liquidity risk describes the risk of not being able to fulfil financial obligations and a lack of ability to finance a wanted growth (Plesner, 2008 & Kodres, 2008).

The credit risk is important to financial institutions in the sense that it evaluates whether a borrower will be able to repay his debt, thus having an effect on the revenue of the bank. Market risk is important to financial institutions because it considers external factors such as the interbank market. Liquidity risk is very relevant to financial institutions, since they are extra exposed to this risk due to their responsibility as financial intermediaries (Plesner, 2008).

In the period leading to the financial crisis market risk and liquidity risk was less considered, since they were found difficult to classify and was therefore often ignored (Kodres, 2008). According to
Plesner (2008), credit risk, market risk and liquidity risk are highly correlated and should be treated holistically to get an accurate picture, thus leaving out parts would give a distorted impression of the actual risk.

During the years 2000 to 2006 there has been an increased focus on quantitative risk measurements, here among focusing much on credit risk. This focus has excluded market risk and liquidity risk, hence leaving out the full picture and actual risk. Thus complex structured credit products were often assigned the wrong rate of risk, since they consisted of both credit risk, market risk and liquidity risk. In some cases risks were properly calculated and understood, but often this happened at the working level, and miscommunication between the working level and management level made much of the risk analyses of poor quality (Kodres, 2008). Risk evaluations of highly structured products therefore often ended up being of poor quality and misleading character.

The market became extremely vulnerable due to an overuse of wholesale and short-term funding, which was used to support the originate-to-distribute business model. The market became increasingly dominated by a business, which focused on the willingness of investors to invest in asset-backed papers and securities. Quality loans focusing on short- and long-term mortgages with a stable nature, and with applicants who was most likely to repay their debt, used to be the norm, but recent years this has changed. Thus, banks are no longer secure in the form of stable long-term deposits, but have become more dependent on the interbank market (Kodres, 2008).

The financial crisis has drawn attention to the problems regarding the areas of risk management, rating agencies, wholesale funding and the use of the originate-to-distribute model.

Financial institutions will in the future have to re-structure areas within corporate governance to correct the damages that insufficient attention has caused. In the future risk managers will require just as much attention as business managers. This will have to be implemented throughout regulations or long-term performance demands required by the shareholders.

Management benefits should be determined on a cyclical basis to avoid a lack of consideration for risk management. A way to establish an incentive for more appropriate credit discipline could be implemented throughout the originator by assigning him some of the risk linked to loans’ future prospect. Also rating agencies have to undergo changes. Earlier rating agencies have been paid by those entities requesting the ratings, creating a possible incentive to manipulate the numbers. Future agencies will be characterised by more independent checks of various parts to avoid misinterpretations (Kodres, 2008). Lastly wholesale funding demands more attention. Wholesale funding is characterised by being effective in good times but damaging in bad times. Wholesale funding is a cheap way to obtain liquidity in good times due to a stable and low interest rate, but the
effects of bad times can be extremely damaging to financial institutions and in worst case demand help from the central bank (Kodres, 2008).

3.5. A Crisis Turning Global

The global financial crisis quickly showed signs of turning global. This is partly an effect of a globalising world, which has made cross-border businesses possible. Thus, the US is not the only country suffering from bad decisions and investments. Many European countries invested heavily in the highly risky structured products originating from the American subprime mortgages. From the global financial crisis it is highly evident that the financial sectors worldwide are highly correlated (Ellemose, 2009). Furthermore the US was not the only country speculating in real estate investments. Many European countries show same tendencies including Great Britain, Germany, and Denmark. Improving conditions with a global growth marked the financial market and none of these conditions were expected to change in the near future. Investors were willing to take increasingly more risk and this behaviour became the norm in spite of little knowledge of the risks connected to the investments (Kodres, 2008).

The Danish banking sector used to be characterised by reasonable banking business. Highlighted by Jørn Astrup Hansen, Chairman of the board of Ebh Bank, is the lack of old classic bank virtues. As the case of many other countries, Danish banks have recent years been marked by a banking sector, which has strived for growth causing classic bank virtues to be put on hold. This means that the Danish banking sector has become very vulnerable and a part of the global financial crisis (Groser, 2008b).

The subprime crisis having turned into a global financial crisis has also hit Denmark. The first sign of a Danish financial crisis, and strongest indication of the degree of seriousness it was going to turn into, was the collapse of Roskilde Bank (Hadbjerg, 2008). It is noteworthy that the Danish financial sector is not only suffering because of the global financial crisis, but also due to problems within the Danish financial sector. Therefore the subject deserves just as much attention on the national factors as well as the international factors (Bechmann, 2009). This will be discussed in chapter 5.

The Danish Financial Supervisory Authority paid extra attention to the Danish banks already in the spring of 2007 (Hadbjerg, 2008) They were concerned about the increasing deposit deficit many banks were running, but banks insured that everything was going as planned, and it was therefore not questioned any further (Hadbjerg, 2008).
3.6. Summary: The Financial Crisis

Recent years the financial markets have been characterized by low nominal interest rates, low financial market volatility, decreasing lending standards, and rising house prices. This has turned out in a financial crisis affecting the entire world. Most people are today familiar with the subject of the American subprime mortgages, which partly together with adjustable rate mortgages, teaser rates, NINJA loans, Liar loans, and an exploitation of the originate-to-distribute model has resulted in the greatest crisis, since the Great depression. Complex structured credit products were created to utilize an increasing demand of high-yielding securities, and a lack of appropriate and responsible risk management have been used within the financial market. This has resulted in an extremely vulnerable market due to a risky and increased use of short-term funding.

In common with many other sectors the financial sector has also undergone a globalization, which means people worldwide has been affected by the crisis. The Danish financial sector has experienced difficulties caused by the American subprime crisis. Meanwhile it is interesting to investigate the Danish banking sector, which has created its own problems. These are similar to those of the American crisis, but it is worth noticing that the Danish crisis to a great extent is due to national problems.

As this chapter states, banking sectors worldwide have been affected by the financial crisis, including great problems within the Danish banking sector, which will be introduced in the following chapter.
4. The Danish Banking Sector

This chapter will give a brief introduction to the Danish financial sector emphasising the parts, which has been involved and affected by the financial crisis. This will provide an insight into the Danish banking sector.

In connection with the financial crisis many banks experienced problems – most frequently liquidity and solvency problems. A few banks were not able to settle their business and an agreement was made between the Danish state and the financial sector to establish Finansiel Stabilitet A/S. Finansiel Stabilitet was established to help distressed banks and to settle these banks in a proper and reasonable way to secure the Danish financial stability (Finansiel Stabilitet, 2010).

4.1. The Danish Central Bank

The Danish central bank was established in 1818 independent of the Danish state. The task of the Danish central bank was to get the monetary system back in order after a period of unrestrained use of money making. This was a change from a time with centralisation driven by the king and government, but a necessity to get the Danish monetary policy back on track. The making of money had run out of control especially during the war causing the Danish inflation to increase remarkably. The central bank was given the responsibility to issue banknotes for the next 90 years (Wendt, 2009). Today, the Danish central bank still has the exclusive right to issue bank notes, and operates as the Danish monetary authority. Thus the main purpose of the Danish central bank is to maintain a stable monetary system. Also, the Danish central bank is in charge of all Danish central government debt-related management issues (Wendt, 2009).

The Danish central bank operates independent of the government with three main objectives. First it is very important to maintain a stable Danish krone (DKK) and hence maintain stable prices on the Danish market. This is partly done by focusing on a low inflation rate (Danmarks Nationalbank, 2010). Denmark runs a fixed exchange rate policy demanding a stable DKK to the euro, which makes the DKK dependent of the euro. This means that the euro is highly considered when focusing on this subject (Ellemose, 2009 & Wendt, 2009).
Also, the central bank provides secure payments by contributing to a secure environment concerning both cash and electronic payments (Danmarks Nationalbank, 2010). This is done by providing coins and bills, and by making available the facilities necessary for transactions and payments between the banks (Ellemose, 2009). This includes the opportunity to make deposits and short-term loans with the Danish central bank (Wendt, 2009).

At last, one of the main objectives is to keep stability in the financial system, which partly is done by monitoring the financial actions (Danmarks Nationalbank, 2010). Furthermore the Danish central bank has the responsibility of managing the debt of the state and evaluates the financial stability of Denmark (Ellemose, 2009 & Wendt, 2009).

The Danish central bank has the responsible of the Danish monetary policy. This mainly includes determining the different interest rates, hereby the official discount rate and lending rate, and the deposit and lending rates offered by the banks to the customers. Furthermore the Danish central bank represents the banks of Denmark in certain connections and cooperates with other central banks (Wendt, 2009).

The main product within the banking sector is money, which makes banks differentiate from other businesses. The main purpose of a bank is to create revenue from its product. The banking sector’s main income is derived from loans and deposits, which makes a profit by charging a higher interest rate than the interest rate offering its depositors. Furthermore banks charge different fees to services offered within the bank. Also very important is profit from engaging in trading, including shares, bonds, and currency (Ellemose, 2009).

### 4.2. The Danish Financial Supervisory Authority

According to Law on Financial Business\(^8\) supervision of Danish financial institutions has to be performed, which is done by the Danish Financial Supervisory Authority\(^9\) (DFSA). The main task of the DFSA is to supervise Danish financial institutions having its main focus on banks ability to fulfil the rules of solvency (Retsinformationen, 2007 & Finanstilsynet, 2010). Rules of solvency have been established to secure and protect creditors. Rules of solvency require banks to meet certain demands. As a minimum the capital base of a bank needs to be 8 percent of the risk-weighted items. This demand is referred to as the demand of solvency. Furthermore the capital base has to consist of at

\[\text{Lov om Finansiel Virksomhed}\]

\[\text{Finanstilsynet}\]
least €5 million, which is referred to as the minimum capital requirements. These requirements can be adjusted and determined in accordance to the individual bank, but the requirements cannot be lower than the demand of solvency and capital requirements. Some situations require higher requirements of solvency to meet the risks of the individual bank. Rules of solvency have the purpose to secure that all banks are able to meet the demand of their creditors. Internal procedures have been established so the individual banks are able to measure and control their level of risk (Wendt, 2009 & Finanstilsynet, 2010).

In connection with the financial crisis many banks experienced liquidity and solvency problems. The DFSA had the responsibility of spotting these banks and make them solve the problems either by re-establishing their liquidity or by selling the bank. Most banks handled the problems on their own – the larger part by engaging in M&A. Among others, the DFSA stopped BankTrelleborg, Roskilde Bank, Ebh Bank, and Bonusbanken due to consequences of the financial crisis (Bechmann, 2008).

### 4.3. Finansiel Stabilitet A/S

Finansiel Stabilitet was established in October 2008 with the purpose to help distressed banks and to settle these banks in a proper and reasonable way to secure the Danish financial stability (Finansiel Stabilitet, 2010) The government considered the effect bankrupt banks would have on the remaining financial institutions, and thereby concluded that actions had to be taken to prevent a total frozen interbank market. This resulted in the establishment of Finansiel Stabilitet as well as governmental financial support (Ellemose, 2009).

The main purpose of the establishment is to secure depositors and other simple creditors of banks that are members of Det Private Beredskab10 (Finansiel Stabilitet, 2010). Finansiel Stabilitet is owned by the Danish state through the Ministry of Economic and Business Affairs, and is today the 8th largest Danish bank consisting of eight banks: Ebh Bank, Fonia Bank, Løkken Sparebank, Nova Bank Fyn, Pantebrevsselskabet af 2. Juni 2009, Roskilde Bank, Straumur Burdaras Investment bank hf, and Finansieringsselskabet af 11/2 2010 A/S (Finansiel Stabilitet, 2010).

Banks which are not able to fulfil the rules of solvency and find optional solutions to their problems will be helped by Finansiel Stabilitet, which offers four ways of helping (Finansiel Stabilitet, 2010):

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10 Association established by The Danish Bankers Association to help distressed banks, which are close to bankruptcy (Finansrådet, 2010b).
1. Offer necessary capital to establish a subsidiary, which can help the bank getting settled in a proper and controlled way.

2. Contribute with responsible capital into a new-established bank and gain controlling influence.

3. Transfer the bank to another bank assigned by Finansiel Stabilitet.

4. Pay a one-time payment to acquire a distressed bank

Thereby, Finansiel Stabilitet offers various solutions to meet and solve the problems of the Danish banks, which are members of Det Private Beredskab.

4.4. Danish Financial Rescue Packages

In connection with the global financial crisis the Danish state has implemented two financial rescue packages, and a third has been introduced. The purpose of the first rescue package was to help the liquidity problems the banks were experiencing, while the second had the purpose to secure the banks capital base, and make them able to establish a foundation for future continuation of the banks (Ellemose, 2009).


The first financial rescue package was introduced October 5th 2008 to provide a 2-year guarantee on all deposits and simple claims in Danish money institutions for members of Det Private Beredskab (Retsinformationen, 2008).

The money institutions have to pay a provision of DKK 15 billions to the state to be a part of the guarantee. Furthermore the financial institutions need to guarantee DKK 20 billions to cover losses in connection with settlements of distressed financial institutions. The total payment will therefore end up between DKK 15 and 35 billions depending on the amount of loss. (Retsinformationen 2008; Totalbanken, 2009 & Danmarks Nationalbank, 2009) It is an optional rescue package, but the majority of the Danish financial institutions have chosen to accept the offer (Danmarks Nationalbank, 2009).

11 Lov om Finansiel Stabilitet
4.4.2. Financial Rescue Package II: Law on State Capital Contribution to Credit Institutions\textsuperscript{12}

While the first rescue package solved an immediate problem, it was only helping in the short term and a second rescue package was of need and introduced on February 3\textsuperscript{rd} 2009 with a more long-term purpose (Ellemose, 2009).

Financial rescue package II gives credit institutions the opportunity to apply for state capital contribution totalling DKK 100 billions. To qualify for financial rescue package II the credit institutions, among other requirements, have to meet the law requirements of solvency. When qualified for a capital contribution an individual interest rate will be discussed and agreed upon (Retsinformationen, 2009 & Totalbanken, 2009). Financial rescue package II was to help financing healthy activities to prevent bankruptcies of healthy companies and inactivity within healthy households, and thereby minimizing the risk of liquidity problems.

Every credit institution receiving capital contribution are required not to tighten lending standards more than regular economic development dictate, of course with the notice that the institutions have to consider a healthy and responsible business (Retsinformationen, 2009 & Totalbanken, 2009). Furthermore a credit institution receiving support has to supply the Ministry of Economic and Business Affairs with a report of the institutions development of lending every 6 months. The report will have to include the development of the loans and prospect changes that will affect the evaluation of bank customers. Also the bank lending policy has to be described, as well as prospect changes in the policy needs to be informed.

4.4.3. Financial Rescue Package III

Following financial rescue package I and II, a third financial rescue package has now been introduced and will take effect on October 1\textsuperscript{st} 2010. Financial rescue package III will serve as an extension of the present deposit guarantee with certain constraints. Customers will from October 1\textsuperscript{st} 2010 be covered by a deposit guarantee with a limit of DKK 750,000 (Jyllandsposten, 2010 & Børsen, 2010b). The deposit guarantee will be covered by the banks, thus taxpayers will not suffer from the agreement, Minister of Economic and Business Affairs, Brian Mikkelsen guarantees. In connection with the third financial rescue package a model has been created with directions of how to settle distressed banks as fast as possible. Finansiel Stabilitet will still take part in the settlements of the distressed banks, but it will be re-constructed in a way that guarantees the deposits of loans of ordinary customers (Børsen, 2010e).

\textsuperscript{12}Lov om Statslig Kapitalindskud i Kreditinstitutioner
The financial rescue package has been introduced to establish a stable and secure environment of the deposits belonging to private customers, as well as to make sure that companies are better secured if their bank goes bankrupt (Børsen, 2010e).

The future financial rescue package will therefore secure banks and customers to a certain degree in the future. At the same time banks and individuals will be forced to get involved and act more responsible, since the deposit guarantee is limited to DKK 750.000 opposed to an earlier unlimited guarantee (Børsen, 2010e).

The Danish banking sector has been introduced with an emphasis on the parts that have been influenced by the financial crisis, as well as the initiatives made in this connection. The following chapter will introduce the problems and subjects relevant for the Danish banking sector related to the financial crisis.
5. Danish Banks and the Financial Crisis

The following chapter will focus on the problems the Danish banking sector has experienced in relation to the financial crisis. It will especially emphasise an increased Danish deposit deficit as well as a lack of appropriate corporate governance, which has been the main subjects of the Danish financial crisis.

After a period with a stable and healthy economy the Danish banking sector has now become a part of the global financial crisis. Danish banks have created a deposit deficit totalling DKK 5 billions (Bechmann, 2008). The Danish banking sector is now struggling with an interbank market characterized by insecurity leading to a situation where banks are unable to provide liquidity (Bechmann, 2008). The global financial crisis originating from the American subprime crisis has not directly affected Danish banks. The financial crisis Danish banks are experiencing have been influenced by the side effects from the American subprime crisis such as funding problems, capital loss on securities, as well as increased depreciations (Grosen, 2008a). Especially two reasons are essential in the difficulties the Danish banks are experiencing in connection with the financial crisis. First of all the Danish banks have created a large deposit deficit. Secondly a large part of the Danish banks have problems within corporate governance. These are the result of years with lack of focus on classic bank virtues (Grosen, 2008b).

5.1. Deposit Deficit

In the years leading to the financial crisis the Danish banking sector created a huge deposit deficit, since Danish banks did not have enough valuable depositors to cover their increasing lending growth (Bechmann, 2008).

A bank has three sources to money including stock capital, deposits, and loans. It is common that banks in certain periods will need extra capital to finance their lending, e.g. at the end of the month when deposits are low and salaries will have to be paid. Especially the period leading to the financial crisis has demanded extra financing, since banks have not been able to finance their lending with deposits. Therefore, banks need to make short-term loans to cover periods with deficits, causing many
banks to use external sources to finance lending (Ellemose, 2009).

When the financial crisis struck the interbank market started to freeze making banks extremely careful regarding their lending of liquidity. It became more difficult to evaluate whether a borrower would be able to repay a loan, which increased awareness of risky lending (Grosen, 2008a).

In the beginning of the financial crisis larger banks were gaining advantage of the situation. Customers moved their money from smaller banks with risk of bankruptcy, due to liquidity problems, to larger banks, which still were able to acquire liquidity. As the crisis developed the entire banking sector became involved. This became an enormous problem since banks were no longer able to finance their difference in deposits and lending on the interbank market as they used to (Bechmann, 2008). The international interbank market was especially affected, since it was not included in the first financial rescue package. Therefore banks had almost no possibility of external financing (Danmarks Nationalbank, 2009).

5.2. Corporate Governance

In Denmark it is common to have a major shareholder if your company is listed. This is not the situation within the Danish banking sector. Majority of Danish banks is isolated from the stock market amounting to about two-thirds of all banks (Bechmann, 2008). To be isolated from the stock market means that the bank does not have a major shareholder. A shareholder is a major shareholder if he holds more than 5 percent of the votes, and is a controlling shareholder if he has more than 20 percent of the votes. In Denmark, only 34 percent of the Banks have a controlling shareholder, and only 7 percent have a major shareholder. Especially smaller banks are characterized by a distributed ownership, which means that a large part of the Danish banks are run and controlled by the bank managements. This gives the bank management the opportunity to consider their own interests instead of the shareholders, which studies show has been the case in many situations (Bechmann, 2008).

Being isolated from the stock market gives management a larger freedom to explore and make risky investments, investments that were in the interest of the management instead of the shareholder. The management have had a lack of discipline as a consequence of the lack of observation (Bechmann, 2008). This lack of discipline has most likely had a great effect on the situation Danish banks are experiencing in regard to the Danish financial crisis. Many Danish banks are responsible for the problems they are experiencing due to a lack of proper and responsible corporate governance (Bechmann, 2009).

One of the important issues within responsible banking is the long-term funding and financing. During
the years leading to the financial crisis many banks have had an explosive lending growth, which in many situations only were financed with short-term loans. This made the banks very vulnerable to possible changes (Ellemose, 2009), and is an example of the risky management behaviour that has caused many banks severe problems.

Research show that banks with distributed ownership have been the banks with difficulties regarding the financial crisis. This indicates that banks suffering from the financial crisis have been banks with risky investments due to a lack of discipline within bank management (Bechmann, 2008). According to Anders Grosen (2008a) it is relevant to evaluate the actual reason to the degree of seriousness the financial crisis has become, since a lack of corporate governance might be part of the answer rather than a financial sector that has failed.

5.3. The example of Roskilde Bank A/S

The livelihood of the banking sector exists from selling and investing money. This demands a great deal of trust within the entire sector from customers to internal and external money markets. With the introduction of the global financial crisis this trust was tested. This resulted in a financial sector where nobody trusted anybody due to a highly risky market and extreme insecurity. Nobody was willing to take any risk, which ended in more or less a total shut down of money flow. The lack of trust resulted in a situation where many banks suffered severely and had to get help in some sort of way (Ellemose, 2009).

A characteristic example is Roskilde Bank, which was one of the first signs of how bad the financial crisis was going to strike Denmark (Hadbjerg, 2008). Roskilde Bank became a victim of risky investments in relation to a highly expanded real estate market. Roskilde Bank had created a large deposit deficit whereupon a large amount of depreciations were made which put the bank in a very undesirable position (Ellemose, 2009). Roskilde Bank sought help from the Danish central bank because of insufficient liquidity. On August 24th 2008 Roskilde Bank was declared insolvent and with no interested buyers, the central bank acquired Roskilde Bank (Danmarks Nationalbank, 2008). This was an unusual situation, since the central bank had acquired no banks since 1928, but the Danish central bank responded to avoid a total meltdown of the trust within the Danish banking system (Ellemose, 2009). On September 29th 2008 an agreement between the acquired Roskilde Bank and Nordea, Spar Nord, and Arbejdernes Landsbank was made acquiring 9, 7 and 5 branches respectively (Roskilde Bank, 2008). Likewise, other Danish financial institutions have experienced the consequences of past irresponsible management behaviour and the financial crisis leading to
situations where settlements have been necessary or in worst cases resulted in acquisition by Finansiel Stabilitet.

5.3. Summary: Danish Banks and the Financial Crisis

The Danish banking sector is today greatly involved in the financial crisis, and has acquired a huge deposit deficit. This is from a period with risky management behaviour, and a lack of classic bank virtues. The Danish banking sector have been characterised by distributed ownership, which have enabled bank management to gain an extreme amount of control. The best picture of the Danish state suffering from the financial crisis is given in the case of Roskilde Bank. Roskilde Bank demonstrated an extreme type of behaviour, which was marked by a huge deposit deficit and very irresponsible management behaviour.

The main problems within the Danish banking sector during the financial crisis have been discussed. The situation the banks are experiencing has lead to an unusual increase in consolidations, struggling to recover the liquidity problems the crisis has brought. The following chapter will focus on motivational factors to engage in M&A to gain an understanding of the development within bank M&A.
6. Motives for Bank Mergers and Acquisitions

In the following chapter advantages, disadvantages and motivational factors of M&A within the banking sector will be discussed. This will include both economic and non-economic motives affecting the decision to engage in M&A.

During the past 15-20 years the development within the financial sector has been characterised by increased M&A activity. The focus on M&A within the global financial system has been high and several entities have consolidated. This is partly reasoned by a century, which has been dominated by technological innovation, globalisation, and deregulation (Focarelli, 2002). The fifth wave of M&A activity starting in Europe in the 1990s was followed by the recent implementation of the Single Market and the Monetary Union encouraging financial institutions to keep engaging in M&A activity (Cybo-Ottone, 2000).

The present bank M&A activity is highly marked by the financial crisis, but also the previous years of deregulation and globalisation have had a great effect. M&A activity has in many cases been applied simply to survive the financial crisis, often having been advised to do so by the DFSA with reference to the rules of solvency and the like. In 1996 deregulation was implemented in the sense of remote market access making it possible to access all financial institutions domestically within the European Union (Focarelli, 2002). Common rules to member states of the EU together with the implementation of the euro made it easier to move cross-borders and increased competition (Heffernan, 2005). As well as deregulation globalisation has been greatly involved. Technological innovation, telecommunication and the Internet have expanded the opportunities within the banking sector. Globalisation combined with a strongly developed telecommunication and information system made it less important to focus on one particular sector. It became possible to engage across the sectors of the financial industry encouraging M&A activity (Focarelli, 2002).

6.1. Motives for Mergers & Acquisitions

The general perception is that M&A is applied to generate added value to a business by reducing costs and/or increasing profits (Houston et al, 2001), but other motives are also highly relevant when
discussing M&A within the financial sector.

Acquisitions are mainly applied as a part of a business or corporate strategy. The reasons for making an acquisition are many but generally they can be connected to one of three approaches: Resource-based view, Industrial economics/positioning perspective or managerial perspective.

"Under the resource-based view, we would expect an acquisition to be related to leveraging, developing or increasing the capabilities of the organisation" (Hubbard et al, 2008, p. 289)

"Under an industrial economics/positioning perspective, we would expect an acquisition to be made to increase market share, to decrease costs, to decrease risks, or to take advantage of undervalued opportunities" (Hubbard et al, 2008, p.289).

"Under managerial perspectives, M&As might be undertaken to achieve managerial goals such as growth, size, power or personal rewards, though these may not be ‘rational’ reasons." (Hubbard et al, 2008, p.289)

Thus, Hubbard et al (2008) states that an organisation will be motivated by one of the three approaches focusing on a resource-strong development, financial perspective, and management attractive results, respectively.

6.1.1. Resource-based View

Compared to other businesses the banking sector differentiates by having money as its main product. The special character of the business demands certain regulations, and rules apply to secure a financial stability. In this connection illiquidity and insolvency are highly relevant issues. Financial leveraging is therefore a highly relevant motive for banks to engage in M&A. A great example is reflected in the current financial crisis, which has caused many banks to engage in M&A due to insolvency (Bechmann, 2009). Sharing of knowledge and know-how is another resource-based motive. This can be done with the focus on different areas including resource-sharing, functional skill transfer, management skill transfer or a combination of the mentioned areas. Functional skill transfer refers to the acquirer’s ability to apply its operating skills on the acquired company, whereas managerial skill transfer refers to the ability to share management skills to enhance decision making and management information systems (Hubbard et al, 2008). The obvious way to share knowledge is to share tangible knowledge such as operations, distribution, and R&D (Hubbard et al, 2008). A way of adding value to a bank could be done by achieving access to the acquired bank’s customers or customer segments and to
complementary products and services, and thereby strengthen or leverage the core of the business (Copeland et al., 2000) In many cases knowledge and know-how can be gained less costly by applying M&A, and thereby exploit the resources of the merged companies. Especially, R&D is an expensive procedure, which can be avoided by knowledge sharing thus avoiding unnecessary costs on R&D (Lipczynski, 2009). Many financial institutions prefer to expand their business by applying M&A, since this is a faster way to grow, and it attracts essential expertise and human capital to the financial institution, which did not already exist internally (DeYoung, 2009).

6.1.2. Industrial Economic/Positioning Perspective
Banks can have different motives to engage in M&A, but the main value created from M&A can be connected to the synergies gained through consolidation. These synergies consist of various different synergies, but most importantly cost savings, revenue enhancement, and process improvement are highlighted (Eccles, 2009).

6.1.2.1. Cost Savings
The most common way of achieving cost savings is through economies of scale and scope. Economies of scale and scope are common advantages of using M&A and lead to improved cost efficiency. M&A gain economies of scale and scope by decreasing, variable and fixed, costs of different operations, e.g. within purchasing, production, administration, marketing, and distribution, and thereby improve profits (Hubbard et al, 2009). A bank creates value by utilising functional economies of scale to cut costs and improve product and service quality (Copeland et al., 2000). Cost savings are created by consolidating operations, avoiding unnecessary costs like managerial positions and excess staff, closing overlapping departments, and consolidating bank office functions (Houston et al, 2001). Studies show that cost savings are most successful when the merging banks are geographically overlapping making it possible to close overlapping branches (Walter, 2004).

The importance of economies of scale and scope has been emphasised during the past 15 to 20 years. This is due to the globalisation that has greatly affected the banking market and enhanced competition. Especially, IT technology has made it more difficult to distinguish between the different sectors, and thereby forced banks to apply a different business approach (Focarelli, 2002).
6.1.2.2. Revenue Enhancement
In the case of some M&A activity revenue enhancement can be gained through sales growth if the merging banks are more efficient combined than separately as well as new opportunities can emerge from combined complementary resources (Eccles, 2009). The improvements of M&A achieved by revenue enhancement are often rather difficult to assess due to implications of external factors with a lack of management control. Thus, revenue enhancement is often not included in the predictions of synergy value.

According to Houston et al. (2001) cost savings have a greater influence on improvements within bank M&A than revenue enhancement. Revenue enhancement effects bank M&A with a total average of the aggregated synergy gains of only 7 percent.

In spite of its difficulty to estimate, revenue enhancement is still found to create value. The most common way of creating value is by cross-selling bank services (Eccles, 1999). By applying M&A the bank can gain new ways of diversifying and thereby making it possible to improve access to different market segments (Walter, 2004). Examples of this could include a superior or complementary product brought by the acquired bank to be used through the distribution channel of the acquirer. Likewise the opposite is an option; the acquired bank’s distribution channel is an option to improve sales of the acquirer.

6.1.2.3. Process Improvements
Process improvements are created from transfers between the merging banks of their respective core competencies. This includes the benefits gained from technology and internal skills. The procedure of process improvements leads to both cost savings and revenue enhancement. Improvements within processes of product development can also be created in return producing a better and cost-reduced product (Eccles, 1999). Process improvements can be created both within the acquired company as well as the acquirer (Focarelli, 2002).

The synergies can result in great advantages, but it demands preparation and a well-planned implementation and execution of the entire process to gain maximum benefits from M&A activity. It demands not only preparation for the actual M&A activity, but also for a post-merger integration. A lack of proper implementation can destroy even the best strategy (Walter).

6.1.2.4. Other Economic Motives
Other attractive motives to engage in M&A include among others increasing market share and power, decreasing risk, taking advantage of undervalued opportunities, technological innovation, and tax
benefits. Strategically, a bank can choose to apply M&A to increase market share, and thereby make it more attractive for shareholders to invest in the bank. An increased market share will most likely also result in a higher competitiveness. In this connection the term 'to-big-to-fail' has been introduced. It has been discussed whether larger banks have had, and still have, the advantage of having a larger market share and thereby inducing less risk (Focarelli, 2002). According to DeYoung et al. (2009) 'to-big-to-fail' "status results in an implicit government guarantee which reduces investor and creditor risk and provides a cost-of-credit advantage over smaller rivals". (DeYoung et al., 2009, p.95) Here among systemic risk is a risk relevant within the banking sector. "Systemic risk can be defined as the risk that insolvency of one large or otherwise important financial institution might cause financial losses and insolvencies at other financial institutions, with the end result being a system-wide financial panic and potential macroeconomic disruption" (DeYoung et al, 2009, p. 97). Roskilde Bank is an example of a bank with large systemic risk. The collapse of Roskilde Bank affected the entire Danish nation by seriously introducing the beginning of a Danish financial crisis. Furthermore, technological innovation has opened up to new opportunities making it more difficult to distinct between the different financial sectors. This has made it more important to diversify and make use of economies of scale and scope (Focarelli, 2009). These advantages have not been discussed as thorough as previous motives due to their less importance compared to other motives regarding the financial outcome of M&A activity.

6.1.3. Managerial Perspective

Much research has been made on the topic of M&A within the banking sector. Many have been trying to cover the advantages and disadvantages within the subject. Yet this has not given a concrete answer, since different results have been achieved and many with the answer that M&A activity do not result in a better performance (Focarelli, 2002 & Houston et al., 2001). Studies implying that M&A do not create value make it therefore interesting to discuss the managerial perspective of M&A activity to find out what motives lie behind the decision to engage in M&A (Houston et al 2001). Houston et al. (2001) indicate that the increasing tendency to engage in M&A is derived from “managerial hubris and/or a massive corporate control problem that results in value destruction for acquiring firm shareholders”(Houston et al., 2001p.286).

Two perspectives are especially interesting to look at. It is interesting to investigate whether managers engage in M&A with the incentive to gain personal rewards. This is especially relevant in banks where the management is paid an incitement. Studies show that managers whose benefits are connected to
the growth of the bank are more likely to engage in risk-taking M&A and use an approach of fast market growth (DeYoung, 2009). This approach is extremely relevant to consider in connection with the Danish banking sector, since Danish banks are characterized by a distributed ownership giving bank management considerable control (Bechmann, 2009). Secondly, empirical evidence shows that some bank managements apply M&A to create growth and thereby gain a larger empire (Gorton and Rosen, 1995). This approach can be used to attain the status of ‘to-big-to-fail’ and the benefits thereof (DeYoung, 2009).

6.2. Drawbacks of Mergers & Acquisition
In spite of many advantages in connection with M&A, disadvantages also exist. The main problems when applying M&A are:

- Lack of management skills
- Lack of focus on intangible assets
- Difficulties within post-merger integration

6.2.1. Lack of Management Skills
Managerial problems can occur when entering M&A. This partly includes the decision of who is going to take the front lead of the activity, as well as picking the person possessing the required skills. Delays of such decisions can lead to delays in cost-cutting efforts as well as decreases in cost-cutting opportunities such as a lack of elimination of excess staff (Houston et al., 2001). The choice of inappropriate managers to do M&A activity can turn certain advantages into disadvantages. Market growth is one of the mentioned advantages of M&A, but according to Roll (1986) this can quickly be turned into a disadvantage if the wrong person is chosen to run the M&A activity. He explains that lack of awareness of own competencies and capabilities can lead to management hubris. This kind of management can influence M&A activity in a way that instead of adding value to the company destroys it (DeYoung, 2009). Furthermore studies show that some management fail to register that some advantages could have been achieved without applying M&A, as well as a lack of ability to register losses in revenue caused by cost savings (Houston et al., 2001). These mistakes can therefore result in inaccurate estimations of the added value gained from M&A.
6.2.2. Lack of Focus on Intangible Assets

Implementation of the different activities after M&A can be difficult and cause problems to managers who are not capable of accomplishing a professional integration of the merging banks. This includes the different working processes, accounting methods and corporate cultures (Brealey, 2007). An important thing to consider in the process of M&A is the human resources, which will represent the combined company. The core value of many businesses depends on a harmonised working force including both managers and other employees. The people who represent the new and combined company need to be considered in order to motivate and show appreciation (Brealey, 2007). It is good to bear in mind that highly qualified employees are attractive to competing banks, and it is therefore important to take the employees into account during the merger process (Walter, 2004 & Lafforet, 2009). Many executives fail to investigate the cultural and people side of the deal (Lafforet, 2009). Thus, many companies do not exploit their opportunities and potential value fully due to a lack of focus on intangible assets, including human capital, business culture, and corporate governance. Instead, companies are characterised by over-prioritising system integration, and by overemphasising financial and system due diligence leading to the mentioned lack of focus on intangible assets. This reflects a negative cultural integration resulting in an increased risk of failing (Hawser, 2007).

Comparing the preparations of different companies prior to M&A show that almost everybody did due diligence on the financials before entering M&A, whereas only 22 percent considered the cultural and people issues on beforehand (Lafforet, 2009).

Studies of previous merger integration within financial services show that the most obvious mistakes made, leading to failure or a company of decreased value, are due to people problems (Davidson, 2004). Furthermore, studies made by Caroline Lafforet and Ruth Wageman (2007) indicated that M&A failures often were due to culture clashes, lack of openness regarding the integration strategy, as well as problems to create the optimal management team oppose to financial and structural integration challenges.

An overemphasis on financial and legal issues will lead to a lack of strategic guidance of the company including issues within leadership, and failure to communicate with key shareholders during the process of M&A (McDonald, 2005). Also, other studies have found an overemphasis on financial issues indicating that these have to be fulfilled for the company even to consider an M&A transaction. This decision is mainly based on strategic rationale (McDonald, 2005). Other studies have showed strategic rationale to have a great effect on the turnout of M&A.

6.2.3. Difficulties within Post-merger Integration

According to Gadiesh and Ormiston the reasons leading to merger failure can be connected to one or
more of five major causes: poor strategic rationale, mismatch of cultures, difficulties in communication and leading the organisation, poor integration planning and execution, and/or paying too much for the target company. They emphasise strategic rationale as this is designated the highest degree of importance due to its effect on both pre and post merger behaviour, while Lynch and Lind focus on the speed of post-merger integration, culture clashes, and lack of appropriate risk management strategies (McDonald, 2005).

6.2.4. Size versus Complexity
Another subject related to M&A failure is the size and complexity of a company. The banking sector has been very affected by the global financial crisis resulting in disasters including bailouts of large financial institutions during 2008 and 2009. These happenings have emphasised the importance of the risks connected to the increased size of banks, which rise concerns about implications for macroeconomic and financial market stability (DeYoung, 2009). In Denmark several banks have been rescued by Finansiel Stabilitet to secure the Danish financial stability. The issue of risk regarding the increased size of banks is important, since a possible future financial crisis will not be able to be financial supported as it has been the case this time (Bechmann, 2009).

Martin Windelin from Danish Competition Authority\textsuperscript{13} explains how the size and increase in market share cause limits on the competition. The competition is very limited within the banking sector compared to other sectors, since a few banks possess a greater part of the market share (Thiemann, 2009)

Another disadvantage of becoming too big is the costs connected. M&A can lead to economies of scale and scope and increased efficiency, but it is also important to consider the costs associated with a company becoming too large and too complex. It is more difficult to manage a large corporation than it is to run a small one. Cost discipline, teamwork, and common culture is more difficult to change if it includes many employees and departments. The degree of complexity is therefore worth to consider when estimating potential cost efficiency (Davidson, 2004). Additionally, management also has to consider and include the risk of customers leaving the bank due to fee increases and changes in services offered by the acquiring bank (Houston et al., 2001).

\textsuperscript{13}Konkurrencestyrelsen
6.3. Summary: Motives for Bank Mergers & Acquisitions

The main motive to engage in M&A can most often be found within three perspectives: Resource-based view, industrial economics/positioning perspective and managerial perspective. The most obvious motive to engage in M&A is to obtain synergy effects. These are most often attained through cost savings gained from economies of scale and scope. The use of economies of scale and scope has especially been emphasised recent years due to technological innovation and globalisation, which has made it even more important to diversify and make use of these.

Revenue enhancement is perceived as a less important factor, but advantages are possible to be gained through cross-selling bank services, as well as new opportunities can emerge from combined complementary resources.

There can be gained many advantages through M&A, but most banks will experience complications during the process. The main problems leading to disappointments and failures are the lack of management skills, lack of focus on intangible assets, and difficulties within post-merger integration. A lack of management skills can lead to delays in cost-cutting efforts and opportunities resulting in lost cost savings. In this connection management hubris is also introduced as a reason for failure.

During the process of M&A the main focus is most often given to financial issues. In this context intangible assets are often ignored, and human and cultural subjects omitted from the decisions leading to the M&A activity. This raises a major problem, since most businesses depend on a harmonised working force, and a lack of appropriate cultural integration will increase the risk of failing. This has been concluded from studies showing that most mistakes are linked to people problems.

Furthermore the issue of a company’s size and complexity has been raised to emphasise the increased difficulties this includes. This concerns both the increased costs this might entail, and the increased risks it might inflict itself as well as others.

Financial issues caused by strategic rationale is greatest considered in the valuation of bank M&A. It can therefore be recommended to put some more focus on issues related to the employees of both the acquiring company and those of the acquired. The key to a successful M&A is therefore found in an analysis, which considers the most accurate picture of the target company’s cultural, human, and structural assets as possible.
7. A Comparison of Bank Mergers & Acquisitions

In the following chapter a comparison of bank M&A in Denmark, EU, and the US will be made. This is done to obtain a broader understanding of the situation Danish banks have been facing regarding M&A activity compared to that of other parts of the Western world.

Bank consolidation is a business activity that has been going on in both the US and Europe for years, and most of the deals have had a successful outcome (Teitelman, 2009).

The last couple of years the banking sector has been in a period of intense consolidation, where the only option for publicly traded banks was to buy or be bought (Teitelman, 2009). During the financial crisis large financial institutions around the world have collapsed, and governments have had to introduce financial rescue packages in order to save distressed and insolvent banks (Dubhashi, 2008, Finansministeriet, 2008 & Shah, 2009). Some banks have had no choice, but to engage in M&A activity to be able to fulfil the requirements set up by governments. M&A activity within the banking sector in Denmark has been of no difference (Finansministeriet, 2008). M&A activity within the Danish banking sector has increased significantly during the financial crisis, compared to Europe and the US (figure 7.1.), but what has been the reason for this remarkable growth? Why has Denmark experienced an increase in M&A activity within the banking sector while other countries have experienced a decline during the financial crisis? These are some of the main issues that will be evaluated in this chapter.
7.1. Danish Mergers & Acquisitions

An increasing number of Danish banks have engaged in M&A during the financial crisis. Not only has the volume of M&A activity within Danish banks increased since 2006, but the volume of M&A adjusted by population size, has also been higher than the countries of comparison since 2007 (figure 7.1.). The Danish banking sector has mainly been facing two problems: First, a general liquidity problem shared by all countries due to the global financial crisis, including in particular the very unusual situation of a frozen interbank market. Second, the Danish banking sector is relatively fragmented (Finansministeriet, 2008). The problem of a frozen interbank market combined with an extremely high lending in Danish banks, has caused severe troubles for the Danish banking sector, which can explain parts of the increase in M&A activity within Danish banks (Bechmann et al., 2009 & Hansen, 2009). According to Bechmann, Professor at Copenhagen Business School (CBS), the development within the Danish banking sector has been that of a risk lover; management in the banks have not been afraid to run huge risks, and this has brought the banking sector in a situation with a lending two to three times larger than in countries of comparison (Hansen, 2009). If Danish banks had not run this kind of risky business they would not have been in the situation they are facing today, and the activity level of M&A would probably have had a slightly different outcome.

The second main problem the Danish banking sector has been facing is that of a fragmented market,
i.e. there have simply been too many banks in Denmark, whereof a great amount have been relatively small. This argument combined with the argument about management running a too risky business indicates that two problems in the Danish banking sector have caused M&A to increase during the financial crisis (Finansministeriet, 2008).

Since 2006 the activity level of Danish M&A within the banking sector has had a sharp increase compared to previous periods (figure 7.1). Besides the already mentioned problems within the Danish banking sector, the most likely causes for this development are first of all the introduction of different rules and regulations set up by the Danish central bank and the EU commission (Focarelli et al., 2002). Secondly, the increase from 2008 to 2009 in M&A activity within the banking sector can to some extent be explained by national factors (Bechmann et al., 2008 & Buch et al., 2009).

Finansiel Stabilitet, took over the control of Roskilde Bank on August 24th 2008 (Finansrådet, 2010a). Many Danish banks were affected by the negative consequences brought to the banking sector in Denmark after the collapse of Roskilde Bank. In the light of this it is reasonable to argue that the collapse of Roskilde Bank, as well as the collapse of other Danish banks, had an influence on M&A in 2009 (Børsen, 2009). Many banks have tried to avoid the trap of bankruptcy by engaging in M&A activity and thereby hoping to obtain operational synergies. M&A to avoid bankruptcy is what has been characterized as ‘shotgun weddings’ in which banks have had no choice but engage in M&A activity in order to survive (Business&Finance, 2009). Furthermore others have engaged in M&A activity to fulfil the capital requirements set on them, and thereby refinancing risk (Finansministeriet, 2008). The situation of Roskilde Bank and other distressed banks in Denmark has influenced the entire banking sector in Denmark (Børsen, 2009) in the way that foreign banks started doubting Danish banks and were no longer willing to refinance loans (Bechmann et al., 2009). This further explains why M&A activity within the Danish banking sector has increased during the financial crisis. Financial acquisitions have especially been popular, since healthy banks, looking for financial synergies, have seen an advantage in acquiring undervalued banks (KPMG, 2009).

To sum up, there are two main causes for the relatively high level of M&A activity within the Danish banking sector: First the problem of liquidity and an extremely high lending rate, and second the problem of a fragmented banking sector mixed with the collapse of several Danish banks.

### 7.2. Denmark Compared to the EU

Europe has been hit hard by the financial crisis, even though subprime mortgages, which caused the crisis in the US, barely existed in Europe (Ewing et al., 2009). The financial crisis has not had the same impact on M&A activity within the banking sector in all the European countries (figure 7.1.). In the
Nordic countries, Denmark is the country which banking sector has been affected the most by the financial crisis. In neither of the neighbouring countries to the north have central banks been compelled to save distressed banks (Børsen, 2009). To get an understanding of reasons why the Danish banking sector has been hit relatively hard compared to that of other European countries, a short analysis of banking sectors in different countries and its M&A level will be carried out.

7.2.1. The EU-27
The total activity level of bank M&A within the EU-27 countries has been decreasing from 2005 to 2009, which is opposite the development of the Danish banking sector. Furthermore, the total activity level of bank M&A within the EU-27 countries, adjusted by population size, has been significantly lower than the level in Denmark (figure 7.1.). This indicates that the different banking sectors in Europe have been able to cope with the financial crisis in different ways. The financial crisis in Europe in general is linked to events in the US, which have caused many problems (Ewing et al., 2009). This explains why activity levels within bank M&A has not been the same, as well as the reasons why some banking sectors in Europe has suffered more than others, where Denmark has been one of the most suffering (Børsen, 2009).

Besides the causes linked to the financial crisis Denmark has had an extremely high increase in lending compared to the rest of Europe. From 2004 to 2008 Danish banks experienced a yearly increase in lending of 25 percent, whereas European banks on average experienced a yearly increase of 10 percent (Bechmann et al., 2009). The extreme increase in Danish lending combined with other problems has caused the Danish banking sector to suffer (Ellemose, 2009).

The economic problems in the EU-27 are almost as diverse as the member countries. This is why it is difficult to make a coherent rescue plan for the entire EU-27, which is needed to create financial stability (Bechmann et al., 2009 & Ewing et al., 2009). If coherent rescue plans had been made, it is reasonable to argue that many ‘shotgun weddings’ between banks would not have happened.

In the light of this difference the following individual countries within the EU-27 will be looked at: Germany, France, and the U.K.

The reason for choosing these three countries within the EU-27 is that their banking systems differ significantly. By comparing Denmark to these three countries as well as the US, four different banking systems will be looked at, where Denmark falls into group 2, which will be described below.

Hagendorff (2008) characterizes the banking sectors the following way:

- **Group 1**: The banking sector is characterized by a sphere where capital markets and banks compete on equal terms, even though the market for banking services is not concentrated.
- **Group 2**: The banking sector is characterized by a low level of market concentration and banks
occupy a leading position in the country's financial system.

- Group 3: The market for banking services is consolidated and the country's economy is bank-based.
- Group 4: The banking sector is characterized by a highly developed stock market, as well as high levels of concentration in banking.

Figure 7.2. Country Matrix: Financial Systems (Hagendorff, 2008, p.62)

Figure 7.2. depicts the different financial systems in regard to market concentration as the first dimension and stock market and banking sector development as the second dimension.

7.2.2. Germany

Germany has experienced an increase in bank M&A from 2007 to 2008, and a slightly decrease in 2009. The activity level of bank M&A, when measured by M&A relative to population size, has been significantly lower than Denmark's throughout the entire period from 2000 to 2009 (figure 7.1.). The main reason why Germany has experienced a relatively low level of bank M&A throughout the period can be explained by its legal obstacles to consolidate. An example of its main obstacles has been between different kinds of institutions within its three-pillar banking structure (commercial, savings, and cooperative banks) (Hagendorff et al., 2007).

The increase in Germany's level of bank M&A in 2005 is due to small public-sector institutions preparing for changes in EU law, which had an effect on its funding strategy after July 2005 (Hagendorff, 2008). Furthermore in 2005 German savings and state banks lost the government guarantees of their liabilities, which earlier on had made them popular. Due to customer fluctuation they were forced to engage in M&A in hope of gaining operational synergies, which was needed to
remain competitive and avoid the trap of bankruptcy (Hangendorff, 2008).

Before 2005 M&A activity within private-sector institutions in the financial sector has been almost non-existing. This supports the reasoning for a low bank M&A level in Germany.

During the financial crisis the banking sector in Germany has encountered the same difficulties as elsewhere, but to a less extent (Goddard et al., 2009).

7.2.3. France
France has throughout the period from 2000 to 2009 experienced a relative low and stable level of M&A activity, with a peak in 2004. The activity level, when measured by M&A relative to population size, has been much lower than Denmark’s throughout the entire period (figure 7.1.). According to Goddard et al. (2009) the French banking sector has been relatively healthy based on many years of continuous growth and strong profitability. This explains why the level of bank M&A in France has been relatively low during the financial crisis.

Even though the banking sector in France entered the financial crisis in a relatively healthy condition it has experienced problems later on during the crisis. Societe Generale, which is the second largest bank in France, was hit by exposure to subprime lending and losses, as well as a claim on fraud of one of its traders, which became known to the public in 2008. The situation of Societe Generale caused various problems in the banking sector in France (Goddard et al., 2009).

In October 2008 the French government provided financial rescue packages, and government bailouts of banks in France became a reality (Goddard et al., 2009).

7.2.4. The United Kingdom
From 2000 to 2009 the U.K. experienced a relatively high level of bank M&A, when measured by M&A in relation to population size, compared to the average level in Europe. Since 2005 the U.K. has experienced a decline in bank M&A (figure 7.1.).

The banking sector in the U.K. has struggled much during the financial crisis. The struggles started with the government bailout of Northern Rock in 2007. The failure of Northern Rock was caused by over-aggressive growth in mortgage lending, over-dependence on short-term wholesale funding, and regulatory failure. The situation of Northern Rock influenced the entire banking sector in the U.K. (Hagendorff, 2008).

London is a global financial centre and has been hit hard by the financial crisis, which has affected the entire banking sector in the U.K. (Ewing et al., 2009). One of the reasons why the U.K. has been hit particularly hard by the financial crisis is London’s position in the global financial sphere. London is a global financial centre and the crisis has therefore had a greater effect in the U.K. than in many other European countries (Hagendorff, 2008).

Besides London being a global financial centre, the banking system in the U.K. differs from many other countries for three reasons: First, retail banking is a fairly concentrated industry by international
standards, with half of all private-sector deposits held in one of the three largest banks in 2004 (Reuters, 2004). Second, the level of market concentration has fallen slightly over the past 20 years caused by new entrants. Third, the majority of banking groups and building societies in the U.K. are controlled by foreign owners. As a result of new entrants into the financial market, M&A activity in the U.K. has reached a higher level (Hagendorff, 2008).

7.2.5. Europe Needs Reforms
The European banking sector has been influenced hard by the financial crisis, but the EU does not have a single government to fashion a coherent rescue plan for the countries in the EU. Only the European Central Bank has broad power over the region’s economy, but it does not have the tools to implement such a rescue plan (Ewing et al., 2009). Furthermore national reforms are needed for the worst situated countries, e.g. Denmark, since it is far from the same problems the financial systems in the different countries have been facing. In Denmark a national reform would restrict the limitation on votes and limitations of ownerships in Danish banks quoted on the stock exchange (Bechmann et al., 2009). According to Mervin King, Manager of the British Central Bank, international reforms are needed to prevent similar situations in the future caused by low capitalization (Bechmann et al., 2009).

7.3. Denmark Compared to the US
The financial crisis in the US has been different from that of Denmark and Europe. According to Angela Merkel, the German Chancellor, the European economy was built for stability more than speed, and this explains why Denmark among others have been able to prevent bank failures on the scale of Lehman Brothers. Furthermore, in the US the financial crisis started with subprime mortgages, which barely existed in Europe. That does not mean that Denmark and the rest of Europe has not been hit by the financial crisis, it just shows that the financial fate of Europe is linked to events in the US. Therefore the collapse of Lehman Brothers has sent Europe in to a financial crisis as the rest of the world (Ewing et al., 2009).

The M&A activity within the banking sector in the US has been slightly similar to the EU-27 countries when measured by number of deals, but sometimes almost twice as high when measured by M&A in regard to population size (figure 7.1.).

From 2000 to 2007 the level of bank M&A in the US has been slightly similar to Denmark’s, but since 2007 it changed. Whereas M&A activity within the Danish banking sector continued its increase in 2007, the US experienced a decline in bank M&A (figure 7.1.). The difference in M&A activity between Denmark and the US can to some extent be explained by high lending. From 2004 to 2008 Denmark
had a yearly increase in lending of 25 percent, compared to 10 percent in the US (Bechmann et al., 2009).

The US has experienced enormous amounts of bank M&A deals, compared to Denmark and other European countries. Besides the size of the country, which of course requires a larger bank capacity, the US has a large number of small banks, which can easily engage in M&A activity (Hagendorff, 2008). During the 1990s the banking sector in the US underwent a dramatic transformation, which was the beginning of nationwide branching and international banking. Banks with a truly nationwide branch structure are slowly to emerge, which is why not many mega-mergers are seen in the US (Hagendorff, 2008).

7.4. Summary: A comparison of Bank Mergers & Acquisitions

From the above comparison it can be summed up that the Danish banking sector has experienced a significantly higher activity level within M&A, measured by M&A in relation to population size, than both Europe and the US. The main reason is the causality of mainly three factors: Danish banks lending policy, a fragmented banking sector, and management running a risky business.

In the light of the information obtained about increasing M&A activity within the Danish banking sector, it becomes interesting to investigate whether an increase in M&A activity is a Danish phenomenon common to all sectors, or just a trend within the banking sector.
8. A comparison of Mergers & Acquisitions in Denmark

This chapter analyses and compares M&A activity within different sectors in Denmark. This is done to understand whether the increase in M&A seen in the banking sector is common for all sectors, or if it is only a phenomenon related to Danish banks.

Studies show that bank M&A in Europe and North America has been different from other sectors during the financial crisis (Zephyr 2010a & Zephyr 2010b). You might wonder if this has been the case in Denmark as well. Therefore a short analysis of the four main sectors in Denmark will be carried out to obtain whether M&A activity has increased within the different sectors, or if it is purely a phenomenon experienced in the banking sector in Denmark.

Denmark has experienced a decline in overall M&A activity since first quarter of 2008 (figure 8.1.) caused by a lack of capital to finance M&A activity (Business&Finance, 2009). From 2007 to 2008 Danish M&A activity decreased by 18.75 percent and in 2009 an increase of 18.46 were recorded.
The global financial crisis has certainly had an impact on the Danish M&A market. In 2009 target companies have been faced with the need, rather than the want, to consolidate, as they had to merge to survive. This has been the case within all sectors in Denmark, but to a different extent, causing some sectors to experience an increase in M&A while others a decrease during the financial crisis (KPMG, 2009). A reason for this difference is that some companies in given sectors have been forced to engage in M&A due to financial difficulties, while others have not been able to engage in M&A because of liquidity constraints (KPMG, 2009).

During the financial crisis some companies have been forced into or out of the M&A market, thus creating an opportunity for healthy and cash-rich companies to benefit from acquisitions of undervalued companies, which often only face a temporarily distressed situation due to the financial crisis (KPMG, 2009).

In the further analysis and comparison of M&A the following major sectors in Denmark will be discussed:

- Financial services
- Consumer & Industrial Markets
- Information, Communication & Entertainment
- Infrastructure, Government & Healthcare

### 8.1. Financial Services

In 2008 M&A within financial services accounted for 9 percent of overall M&A activity in Denmark, when measured by volume, but 47 percent when measured by value (KPMG, 2009). Despite the relative low part of M&A volume within financial services, compared to other sectors, financial services has experienced an increase in M&A activity, beginning in the first quarter of 2008, and peaking in the third quarter of 2008 (figure 8.2.). During 2008 financial services experienced an increase of more than 50 percent in M&A volume and more than a trebling in M&A valuation, which in 2008 increased to €5.6 billions. The increase in M&A activity within financial services was caused by government interventions for stability, as well as forced M&A – both of which have provided relative stability for the banking sector in 2009 (KPMG, 2009).
8.1.1. Banks

The banking sector in Denmark has seen an increase in M&A activity since 2006, whereas this development has far from been the case in general. From 2006 to 2009 the volume activity level of M&A within the banking sector has more than sextupled. As opposed to many other sectors, the banking sector experienced an increase in M&A volume activity from 2007 to 2008 (Figure 7.2., 7.3., 7.4., and 7.5.).

As mentioned in chapter 7.1., the banking sector in Denmark has been facing two problems: first, a problem regarding liquidity and second, a problem regarding a fragmented market (Finansministeriet, 2008). This has caused some small and medium sized banks to be exposed to refinancing risk and forced into a process of restructuring, through private acquisitions and in a few cases in cooperation with the Danish central bank and government (Finansministeriet, 2008).

From 2008 to 2009 the banking sector experienced more than a doubling of the volume of M&A (figure 7.1), which can be explained by capital constraints as well as the strict regulatory environment the Danish central bank and the EU Commission have put on the banks. Many banks engaging in M&A in 2009 have done so in order to cope with liquidity and solvency issues, which have enabled them to meet minimum capital requirements demanded by regulations in the banking sector (KPMG, 2009).

The increase in bank M&A from 2008 to 2009 can furthermore be explained by the lucrative circumstance for engaging in M&A within this sector. Compared to other sectors, it can be argued that the banking sector in some aspects have had better circumstances for engaging in successful M&A
activity. I.e. healthy and strong banks have the opportunity to expand their reach by acquiring distressed banks from Finansiel Stabilitet, leaving the toxic assets behind (KPMG, 2009).

8.1.2. Insurance Companies
In recent years the insurance sector has remained the second most active space for financial services M&A in Denmark, although compared to the activity level within the banking sector it has been limited (KPMG, 2009).

The reason why a limited amount of M&A has taken place within the Danish insurance sector can be explained by the relative stability of the sector caused by insurance companies' access to liquidity through collection of premiums. Despite the relative stability the insurance sector is still affected by solvency risks as many other companies (KPMG, 2009).

To sum up the difference in activity level of the two sectors can partly be explained by the level of stability within the two sectors as well as the level of liquidity problems they have been facing. The banks have experienced a relative instable situation, until government interventions were imposed on them, whereas the insurance sector has been characterized by high stability caused by easy access to cash.

8.2. Consumer and Industrial Markets
Consumer and industrial markets accounted for 50 percent of M&A deal volume in 2008, and 40 percent when measured by value (KPMG, 2009).
Since the first quarter of 2008 Danish consumer and industrial markets have experienced a decrease in M&A, both when measured by volume and value (figure 8.3.). From 2007 to 2008 M&A activity in consumer and industrial markets decreased by 6 percent. This is relatively low compared to the overall decline of 22 percent in M&A activity in Denmark in the same period. Despite the decline of M&A from 2007 to 2009, when measured by volume, consumer and industrial markets experienced more than a doubling of valuation, which in 2008 increased to €4.9 billion (KPMG, 2009). The decline in M&A volume within these markets can be explained by the situation of private equity houses. Private equity houses were not eager to engage in new M&A, but preferred to wait and see how the situation evolved. On the other hand large corporations with positive cash balances have been eager to buy attractive, undervalued targets (KPMG, 2009) to obtain financial synergies.

The reason why M&A volume within consumer and industrial markets have declined less than the total M&A market in Denmark from 2007 to 2008 can be explained by two factors: On the buy-side, company valuations continue to decrease, causing a good opportunity for cash-rich companies to acquire undervalued targets in a hope of gaining financial synergies. On the sell-side, many small to midsized companies will rather want to engage in M&A activity with bigger companies, thus sheltering through the financial crisis (KPMG, 2009).

Despite the relative little decline in M&A volume in consumer and industrial markets from 2007 to 2008, it is noteworthy that these markets slowed down dramatically in the second half of 2008. This was caused by a worsened condition in the M&A market. Not all companies wanting to engage in M&A were able to obtain bank loans to finance this activity, which is why the conditions worsened in the
second half of 2008 (KPMG, 2009).

Despite the doubling of M&A value in 2008, it is not a sign of a general increase in valuation, since 55 percent of the deal value in 2008 can be attributed to British American Tobacco’s acquisition of regional Nordic firms from Skandinavisk Tobakskompagni. In general most M&A transactions made in consumer and industrial markets have had a value less the ones seen in the sector for financial services (KPMG, 2009).

To sum up consumer and industrial markets have experienced a decline in M&A from 2007 to 2009, mainly caused by the inability of companies to obtain loans to finance the activity as well as their insecurity about the future.

### 8.3. Information, Communication, and Entertainment

In 2008 information, communication, and entertainment (ICE) accounted for 12 percent of overall Danish M&A activity when measured by volume, but only 3 percent when measured by value (KPMG, 2009).

![Figure 8.4. Danish Information, Communication & Entertainment M&A Trends (KPMG, 2009, p. 44)]

From 2007 to 2008 ICE experienced a 40 percent decrease in M&A volume and a 33 percent decrease in valuation, mainly caused by unavailability of financing debt over the second half of 2008. ICE has experienced a larger decrease in M&A from 2007 to 2008 compared to overall M&A activity in Denmark, which decreased by 22 percent and valuation increased by more than 15 percent. The development in overall M&A activity in Denmark in 2008 was mainly due to government bailouts of several Danish banks (KPMG, 2009). ICE has experienced a steady level of M&A valuation throughout
the period from 2005 to 2009, with an exception of the fourth quarter of 2005 where valuation increased significantly (figure 8.4.).

ICE has been a sector characterized by relatively large deals and accounts for the largest deal across all sectors the last five years. The deal was seen in the telecommunication sector with the buyout of TDC in 2005 for €11.8 billions by a group of private equity houses. In 2008 the largest deal undertaken in ICE was eBay's purchase of the online company Bilbasen (KPMG, 2009).

As in the case of consumer and industrial markets, cash-rich acquirers in ICE are the ones that have gained the most from the current situation of depressed company valuations. It has given the acquirers the opportunity to acquire undervalued and temporarily distressed companies hoping to obtain financial synergies. Furthermore as long as the financial crisis continues companies will suffer, which brings more toxic assets to the market. These two situations will trigger an increase in M&A activity within ICE in the future (KPMG, 2009).

To sum up ICE has experienced a decrease in M&A volume from 2007 to 2008 due to companies’ inability to obtain loans to finance M&A activity.

8.4. Infrastructure, Government, and Healthcare

In 2008 infrastructure, government, and healthcare (IGH) accounted for 24 percent of overall M&A volume activity in Denmark, but only 7 percent when measured by value (KPMG, 2009).

![Figure 8.5. Danish Infrastructure, Government & Healthcare M&A trends (KPMG, 2009, p. 48)](image)

From 2004 to 2009 IGH has accounted for nearly 30 percent of overall M&A activity in Denmark, when
measured by volume. From 2007 to 2008 IGH experienced a decline of 40 percent in M&A volume, which was double the decrease of the level the total Danish market experienced that year, caused by a period of tough deal making conditions subsequent the financial crisis (KPMG, 2009). Furthermore IGH experienced a sharp decline in valuation from the second to third quarter of 2007, and the valuation has remained at a relative low level since (figure 8.5). As in the case of the other sectors, acquirers in IGH have had the opportunity to acquire undervalued companies and thereby obtain financial synergies.

When looking at the individual sectors, infrastructure has been the most attractive sector within IGH in the four year period from 2005 to 2009, whereas healthcare only have experienced a limited amount of deals (KPMG, 2009).

To sum up IGH experienced a marked decline in M&A volume from 2007 to 2008 caused by a period of tough deal making conditions.

8.5. Summary: A comparison of Mergers & Acquisitions in Denmark

Financial services, hereunder the banking sector, have experienced different developments in M&A activity during the financial crisis compared to other sectors. While other sectors have experienced a decline in M&A activity from 2007 to 2008 the opposite has been the case for the banking sector. This can be explained by the fact that the banking sector had other and better circumstances to work under. Furthermore, the difference in M&A volume between the sectors can partly be explained by their motives for engaging in M&A activity. Banks engaged in M&A to fulfil capital requirements, whereas companies in other sectors mainly sought financial synergies.

The banking sector has been in a difficult situation during the financial crisis causing a huge impact on companies in other sectors and M&A. An appreciable proportion of companies in consumer and industrial markets, ICE, and IGH seeking to engage in M&A were not able to finance this activity. As a cause of a frozen interbank market many bank loans to companies were declined. This explains why the banking sector experienced a different trend in M&A compared to other sectors.

It can be concluded that the increase in M&A activity within the banking sector is not a phenomenon common to all Danish sectors, but purely a development within the banking sector.

In the light of this finding it becomes relevant to evaluate the factors influencing the banking sector during the financial crisis.
The following chapter discusses the various factors influencing the Danish banking sector in relation to the financial crisis. Furthermore the actions taken by the Danish government is questioned and discussed.

M&A activity within the Danish banking sector has been greatly affected by the consequences of the financial crisis starting in 2007, and many banks have been forced to engage in M&A activity simply to survive. This is one of the reasons to the significant increase within M&A in the period between 2005 and 2009 compared to previous years (Danmarks Nationalbank, 2009). The number of deals has more than doubled during this 5-year period (Figure 9.1.).

![Figure 9.1. M&A within the banking sector in Denmark (See appendix 12.2.)](image)

The financial crisis has particularly marked the Danish banks, which have had a significant increase in lending rate dependent on the ability to loan the necessary liquidity on the interbank market (Groser, 2008a). As mentioned earlier, the Danish financial crisis is not only a result of the American subprime crisis, but to a large extent caused by national problems within the Danish banking sector. Thus giving just as much focus to the Danish factors as well as the international (Bechmann, 2009).
9.1. Influential Factors

The increase in M&A activity has been influenced by various factors. The periods leading up to previous M&A waves were characterised by a low or falling interest rate, a rising stock market, and an expanding economy (Gregoriou, 2007).

The M&A market is strongly correlated to the stock market globally as well as within Danish M&A. Additionally the M&A market internationally is marked by volatility in terms of strong growth in some periods followed by sharp falls and vice versa (Milner, 2006). Furthermore, M&A activity within Danish banks has during the financial crisis also been influenced by different rules and regulations set up by the government in cooperation with the Danish Central Bank and the EU Commission (Focarelli, 2002 & Heffernan, 2005). Especially the rules of solvency have had significant consequences and attracted much focus within the Danish banking sector making it necessary for many banks to engage in M&A. The activity of M&A increased severely in 2008 caused by bank insolvencies (Danmarks Nationalbank, 2009). In some cases the situation has been so critical that Finansiel Stabilitet has had to take action and take over the control of several banks, e.g Roskilde Bank, Ebh Bank, and BankTrelleborg.

Previous financial crises have also shown necessity of M&A. In 1990, Den Danske Bank merged with Handelsbanken and Provinsbanken, and likewise did Andelsbanken, Sparekassen SDS, and Privatbanken becoming Unibank. These activities were launched to deal with the ongoing financial crisis. At the time the banking sector was characterised by huge losses, deficits, and financial scandals. The use of M&A was at that point a rational way of dealing with the difficulties regarding the financial crisis (Ellemose, 2009). The main characteristics of the two crises are to a great extent very similar both marked by huge losses, deficits, and scandals.

9.2. A Critical view on Finansiel Stabilitet

It is clear that the activity of M&A within the Danish banking sector has increased significantly recent years (Figure 9.1.). Apparently this has been necessary to the survival of many banks. This development has been influenced by the Danish government affecting both banks and customers, but has the involvement of the Danish government been necessary?
9.2.1. Financial Stability versus Free Market Competition

It can be discussed whether it was the right choice by the government to interfere in saving distressed banks, hereunder especially Roskilde Bank. During the financial crisis many banks were saved from bankruptcy with the help from Finansiel Stabilitet eliminating the amount of bankrupt banks. Finansiel Stabilitet has so far acquired eight banks, and thereby undertaken a great amount of debt. The most memorable situation being of Roskilde Bank, which caused a loss of DKK 6.6 billions on Finansiel Stabilitet (Børsen, 2010c). The Danish population and experts have had a critical view on the interventions of Finansiel Stabilitet on the distressed and insolvent banks. Was it the right decision that was made when the Danish government decided to rescue the distressed banks? Arguments have been made in favour of and against the establishment of Finansiel Stabilitet and its actions. It was necessary to establish Finansiel Stabilitet to secure the Danish financial stability, and to prevent an already frozen interbank market from a total meltdown (Bechmann, 2008). The Danish government and central bank were afraid of the potential panic it could create if they started to let banks go bankrupt (Ellemose, 2009). Also, arguments state that the government influences banks positively as a shareholder during a financial crisis and that it is often seen as a sign of strength and credibility. This can be an important factor when distressed banks need to borrow capital on the interbank market (Lunde, 2009). Without the government support many distressed banks would not have survived, and the Danish financial stability would be seriously tested (Risom, 2010).

Counterparts argue that Finansiel Stabilitet has had many negative effects. The government acting as a shareholder can have a negative effect on the competition in the banking sector by rescuing distressed banks, which would otherwise have gone bankrupt. This conclusion is made from experiences showing that it can take several years to settle the acquired banks, and the state will therefore become shareholder for more than just a few years resulting in the negative effect (Lunde, 2009). In April 2009, Former Prime Minister, Anders Fogh Rasmussen, and former Minister of Economic and Business Affairs, Lene Espersen also refused and rejected the solution of establishing a state-driven bank (Lunde, 2009). Kim Fournais, CEO and establisher of Saxo Bank, agrees that it is a bad idea when governments interfere in this connection, because it affects the natural free competition on the market. Saxo Bank is known for their support of free competition, and is against the interference of initiatives like the financial rescue packages (Risom, 2010). The decreased competition will in most cases result in fewer benefits for the customers, and the current situation therefore indicates that the customers will pay the price of the recent years dominated by an unstable Danish economy, financial rescue packages, and bank consolidations (Grosen, 2008b). Benefits such as lower interest rates on loans, higher interest rates on deposits, lower transaction fees, and better quality of services will be less relevant. Additionally, customers will likely be affected in terms of extra tax payments to cover the
costs of the initiatives taken regarding the financial crisis (Grosen, 2008b). The spending of tax payers’ money has been questioned especially with reference to Roskilde Bank, and suggestions made proposing that the mistakes made should be a lesson with disciplinary effect for future customers, investors, and shareholders (Bechmann, 2008).

9.2.2. The Danish State as a Bank Owner
The development of Finansiel Stabilitet has also been questioned. It is today the 8th largest Danish bank, and Chairman of the Parliamentary Finance Committee, Financial Spokesman for DF Kristian Thulesen Dahl criticizes the management of the company. The main focus of Finansiel Stabilitet is to settle the rescued banks, and he thinks this main focus has been forgotten. He indicates that a wrong turn is about to happen and that the Danish state is about to become a permanent bank owner if actions are not going to be made. Finansiel Stabilitet was established to help Danish banks and customers, and to settle banks in a proper and responsible way. Kristian Thulesen Dahl therefore recommends that the company settle the banks as soon as possible. He thinks the problem lies within the management who has lost the focus of the company, and that they are not engaged enough in the process of getting the banks settled (Politiken, 2010). Henning Kruse Petersen, CEO of Finansiel Stabilitet, rejects the critique and comments that the management do their best to sell departments and settle the banks. According to him everything worth selling has been sold. The leftovers are parts, which are not ready and possible to be sold yet. He supplement his defend by saying that this is the biggest and most difficult task he has ever had (Politiken, 2010). Finn Østrup, associate professor at CBS, it is a good idea to wait and obtain the best prices possible. He refers to previous situations where Finansiel Stabilitet was criticized by making to fast decisions and selling at too low prices. At the same time he points out that it will be an advantage to the various Danish banks if Finansiel Stabilitet sells the banks now and thereby gives the banks an opportunity to make good and cheap deals – especially for those banks which are already interested (Politiken, 2010).

9.3. A Critical view on Danish Government Interactions
The Danish government has so far offered a deposit guarantee to boost the Danish economy. It has been introduced to stabilise the Danish financial market and to rebuild trust within banks as well as the interbank market (Ellemose, 2009). Additionally, a further extension of the original deposit guarantee has been presented as a replacement of the current deposit guarantee taking effect from October 1st 2010. In this context, Lars Seier Christensen, CEO of Saxo Bank, argues that this is not the
optimal solution to the current problem. He thinks that bank customers ought to carry a risk of 10 percent of their deposit. According to him, this is the only way to eliminate the unhealthy banks and make customers evaluate banks with a critical view before making their choice. Overall, he thinks the Danish state has become too involved, and that it is time for both managements and common people to take responsibility (Børsen, 2010d). Jesper Rangvid, professor at CBS, supports this statement by adding that he also thinks that the full deposit guarantee should be eliminated. This would require the Danish population to engage and think when choosing bank. The problem with the current guarantee is that there is no risk, and in case a bank goes bankrupt the Danish taxpayers will have to cover a prospect loss. The full deposit guarantee the state is running now keeps too many unhealthy banks going. Jesper Rangvid thinks there needs to be a correlation between risk and return for customers to make an evaluation before depositing their money. If the customers carried some risk it would no longer be possible to attract customers based only on a high interest deposit rate, and thereby a healthier market would be created. (Børsen, 2010a).

9.4. Mergers & Acquisitions: A Strategic Fool

In connection with the financial crisis the term M&A has become closely related to banks, which were in desperate need of help. Many assume that banks engaging in M&A experience problems and use this approach as a last option to survive. The financial confederation states M&A as a healthy and necessary activity within the banking sector (TV2 Finans, 2009). According to Michael Budolfsen, vice-president of the financial confederation, many people are mistaken when they conclude that M&A activity applied by banks is equal to difficulties. He thinks M&A activity is triggered by a responsible management who see the strategic advantages in M&A. Especially bureaucratic rules make it necessary to focus on growth (TV2 Finans, 2009). Furthermore, the financial crisis has created a great opportunity for more cash strong banks to make a good deal (Sirower, 2009). When analysing the development within M&A it is therefore important and relevant to consider other motives and strategies to be able to make any conclusions on the reasons for the increase in M&A activity.
10. Conclusion

In 2007 the subprime crisis became a well-known subject. The subprime crisis quickly turned into a global financial crisis, and has affected societies all over the world. In connection to the financial crisis there has been great focus on the banking sector, since it is the driving force for every economy.

The crisis that the Danish banks are experiencing right now is not only due to the global crisis which had its offspring in the US, but also a sign of national problems within the banking sector. The main issues in Denmark have been the high deposit deficits that the Danish banks have been running and problems within corporate governance.

The extremely high deposit deficits are results of several years with high lending rates, where it has not been possible to cover loans with deposits. Therefore banks have chosen to finance their loans on the interbank market. While the economy was still developing positively the banks had no problems to finance this activity, but when the interbank market froze due to the financial crisis, the Danish banks experienced a huge problem. They were no longer able to obtain loans on the interbank market.

Several Danish banks have experienced a lack of corporate governance, which seems to have had a great influence on the way the Danish financial crisis has developed. The Danish banks are characterized by a distributed ownership, which managements have taken advantage of in recent years. Many banks, which have been struck hard by the financial crisis, are banks where the management has been taking too much risk.

In Denmark M&A have been a strategic tool for the banks during the financial crisis. In most contexts it has been used to fulfil certain rules and regulation, including rules of solvency and regulations regarding the level of liquidity within the banks. The mentioned problems have made it difficult for Danish banks to fulfil the rules and regulations and they have been close to bankruptcy. The amount of distressed banks has been increasing during the financial crisis and many have been told by the DFSA to rectify the imbalance of their activities or to settle their business. This has led to an increase in M&A. Many banks have had no other choice, but to engage in M&A activity during the financial crisis in order to survive.

M&A have many advantages motivating bank management to engage in this activity. These advantages can be divided into three perspectives: resource-based view, industrial economic/positioning perspective, and managerial perspective. The main focus has been on the economic and managerial areas, which has raised questions whether actual economic advantages exist or if managerial motives are the actual driving force for M&A within the banking sector. The expected added value from M&A activity is mainly gained through synergies created by consolidation of the banks.

When looking at the economic advantages studies show diversifying results: Some argue that banks
can gain economic advantages through cost savings and process improvements, while others argue that there are no economic benefits from M&A. Besides cost savings and process improvements revenue enhancement is included in the discussion of value creation. Most research show that revenue enhancement does not have any positive effect, but at the same time it is rather difficult to assess and therefore it can be discussed whether it has an effect or not.

The lack of economic advantages makes people wonder what motivates management to engage in M&A. It has been discussed whether banks engage in M&A with managerial motives, through managerial hubris or remuneration. The problem has been that management in most cases has acted in regard to a short-term perspective due to personal rewards instead of focusing on the long-term results. Studies show that managers whose benefits are connected to the growth of the bank are more likely to engage in more risk taking M&A.

The most important factor when comparing the differences in success and failure is integration of people. This is especially with a focus on culture clashes and post-merger integration. Studies show that management have a tendency to overemphasise financial issues, which causes a lack of focus on cultural issues.

Studies have shown that Danish M&A within the banking sector has been different from the rest of the EU and the US in regard to causes and effects leading to M&A. National bank conditions and structures have played an important role in the level of M&A activity each individual country has experienced. It has led to a significantly higher level of bank M&A in Denmark than both Europe and the US, when measured by volume in regard to population size.

Besides the difference in M&A activity within banking sectors in different geographical regions, Danish banks have experienced a development in M&A activity, which is seen different in the other Danish sectors. The reason is that the banking sector has been in a different situation than companies in other sectors. Banks have engaged in M&A activity in order to fulfil capital requirements, whereas this has not been the case within other sectors. Banks have had other circumstances to operate under compared to other sectors in Denmark. Some Danish banks have had the opportunity to acquire banks from Finansiel Stabilitet, where the toxic assets have been left behind.

M&A within the Danish banking sector during the financial crisis have been important and attracted much focus. It has been an important tool for the banks during the financial crisis in order to survive. Even though it has been important with M&A within the banking sector during the financial crisis it does not necessarily mean that it has been creating value. It has been important in the way that healthy banks have been able to survive the financial crisis in spite of the liquidity and solvency
problems. M&A has given many banks the opportunity to fulfil requirements they were not able to fulfil on their own.

It can be concluded that M&A have had an important factor within the Danish banking sector in order for the banks to make it through the financial crisis best possible.
11. Bibliography


Finanstilsynet (2008). The Danish Government and Danish Bankers Association have agreed on measures to safeguard financial stability. 


12. Appendix

12.1. Appendix 1: Validity of Zephyr as Statistical Database

Zephyr seems to contain some imperfections, which have been detected by comparing the data extracted from Zephyr with data from [www.finansraadet.dk](http://www.finansraadet.dk). The data compared has been mergers and acquisitions within the Danish banking sector. The comparison shows that some data contained in Zephyr is not contained in the data from [www.finansraadet.dk](http://www.finansraadet.dk) and vice versa. To proof this, an example of deals included in 2008 will be provided.

<table>
<thead>
<tr>
<th>Acquirer:</th>
<th>Target:</th>
<th>Zephyr:</th>
<th>Finansraadet</th>
</tr>
</thead>
<tbody>
<tr>
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<td>BankTrelleborg</td>
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<td>X</td>
</tr>
<tr>
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<td>Haarslev Sparekasse</td>
<td>X</td>
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<tr>
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<td>Lokalbanken i Nordsjælland</td>
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<td></td>
</tr>
<tr>
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<td>Forstærdernes Bank</td>
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<td>Ringkjøbing Bank</td>
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<tr>
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<td>Bonusbanken</td>
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<td>Sparekassen Himmerland</td>
<td>St. Brøndum Sparekasse</td>
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</tr>
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</table>

It has not been possible to identify which criteria the two databases have been using for their collection of data, but it can be ascertained that both databases contain imperfections and limitations.

When choosing banks as the major sector in Zephyr it also includes other financial institutions and not only commercial banks. In the analysis in chapter 7 the data include all mergers and acquisitions within banks, and not only commercial banks.

Even though Zephyr contains some imperfections and limitations it is believed that the results in chapter 7 still provides the reader with a true and fair picture of the situation of mergers and acquisitions within the banking sector in Denmark, Europe, and the US.

Since Zephyr is the database providing the most data on mergers and acquisitions in different countries, it will be used.
## 12.2. Appendix 2: Excel sheet containing data on Bank M&A

The following tables show the data extracted from Zephyr which will be used in chapter 7, 8, and 9.

### Zephyr: Bank M&A in Denmark (population size = 5.4 millions):

<table>
<thead>
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<th>Year</th>
<th>M&amp;A</th>
<th>M&amp;A/population size</th>
</tr>
</thead>
<tbody>
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<td>2000</td>
<td>5</td>
<td>0.92593</td>
</tr>
<tr>
<td>2001</td>
<td>6</td>
<td>1.11111</td>
</tr>
<tr>
<td>2002</td>
<td>6</td>
<td>1.11111</td>
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<tr>
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</tr>
<tr>
<td>2007</td>
<td>5</td>
<td>0.92593</td>
</tr>
<tr>
<td>2008</td>
<td>8</td>
<td>1.48148</td>
</tr>
<tr>
<td>2009</td>
<td>19</td>
<td>3.51852</td>
</tr>
</tbody>
</table>

### Zephyr: Bank M&A in the EU-27 (population size = 495 millions)

<table>
<thead>
<tr>
<th>Year</th>
<th>M&amp;A</th>
<th>M&amp;A/population size</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>214</td>
<td>0.43232</td>
</tr>
<tr>
<td>2001</td>
<td>222</td>
<td>0.44848</td>
</tr>
<tr>
<td>2002</td>
<td>220</td>
<td>0.44444</td>
</tr>
<tr>
<td>2003</td>
<td>245</td>
<td>0.49495</td>
</tr>
<tr>
<td>2004</td>
<td>217</td>
<td>0.43838</td>
</tr>
<tr>
<td>2005</td>
<td>223</td>
<td>0.45051</td>
</tr>
<tr>
<td>2006</td>
<td>218</td>
<td>0.44040</td>
</tr>
<tr>
<td>2007</td>
<td>211</td>
<td>0.42626</td>
</tr>
<tr>
<td>2008</td>
<td>185</td>
<td>0.37374</td>
</tr>
<tr>
<td>2009</td>
<td>207</td>
<td>0.41818</td>
</tr>
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### Zephyr: Bank M&A in Germany (population size = 82.3 millions)

<table>
<thead>
<tr>
<th>Year</th>
<th>M&amp;A</th>
<th>M&amp;A/population size</th>
</tr>
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<tbody>
<tr>
<td>2000</td>
<td>9</td>
<td>0.10936</td>
</tr>
<tr>
<td>2001</td>
<td>24</td>
<td>0.29162</td>
</tr>
<tr>
<td>2002</td>
<td>21</td>
<td>0.25516</td>
</tr>
<tr>
<td>2003</td>
<td>20</td>
<td>0.24301</td>
</tr>
<tr>
<td>2004</td>
<td>9</td>
<td>0.10936</td>
</tr>
<tr>
<td>2005</td>
<td>23</td>
<td>0.27947</td>
</tr>
<tr>
<td>2006</td>
<td>18</td>
<td>0.21871</td>
</tr>
<tr>
<td>2007</td>
<td>11</td>
<td>0.13366</td>
</tr>
<tr>
<td>2008</td>
<td>22</td>
<td>0.26731</td>
</tr>
<tr>
<td>2009</td>
<td>18</td>
<td>0.21871</td>
</tr>
</tbody>
</table>
### Zephyr: Bank M&A in France (population size = 63.4 millions)

<table>
<thead>
<tr>
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<th>M&amp;A</th>
<th>M&amp;A/population size</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>19</td>
<td>0,29968</td>
</tr>
<tr>
<td>2001</td>
<td>21</td>
<td>0,33123</td>
</tr>
<tr>
<td>2002</td>
<td>17</td>
<td>0,26814</td>
</tr>
<tr>
<td>2003</td>
<td>22</td>
<td>0,34700</td>
</tr>
<tr>
<td>2004</td>
<td>30</td>
<td>0,47319</td>
</tr>
<tr>
<td>2005</td>
<td>15</td>
<td>0,23659</td>
</tr>
<tr>
<td>2006</td>
<td>17</td>
<td>0,26814</td>
</tr>
<tr>
<td>2007</td>
<td>15</td>
<td>0,23659</td>
</tr>
<tr>
<td>2008</td>
<td>12</td>
<td>0,18927</td>
</tr>
<tr>
<td>2009</td>
<td>15</td>
<td>0,23659</td>
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</table>

### Zephyr: Bank M&A in the UK (population size = 60.9 millions)

<table>
<thead>
<tr>
<th>Year</th>
<th>M&amp;A</th>
<th>M&amp;A/population size</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>39</td>
<td>0,64039</td>
</tr>
<tr>
<td>2001</td>
<td>59</td>
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<tr>
<td>2002</td>
<td>66</td>
<td>1,08374</td>
</tr>
<tr>
<td>2003</td>
<td>69</td>
<td>1,13300</td>
</tr>
<tr>
<td>2004</td>
<td>50</td>
<td>0,82102</td>
</tr>
<tr>
<td>2005</td>
<td>69</td>
<td>1,13300</td>
</tr>
<tr>
<td>2006</td>
<td>65</td>
<td>1,06732</td>
</tr>
<tr>
<td>2007</td>
<td>63</td>
<td>1,03448</td>
</tr>
<tr>
<td>2008</td>
<td>55</td>
<td>0,90312</td>
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<tr>
<td>2009</td>
<td>42</td>
<td>0,68966</td>
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### Zephyr: Bank M&A in the US (population size = 301 millions)

<table>
<thead>
<tr>
<th>Year</th>
<th>M&amp;A</th>
<th>M&amp;A/population size</th>
</tr>
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<tbody>
<tr>
<td>2000</td>
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<td>0,79070</td>
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<tr>
<td>2001</td>
<td>320</td>
<td>1,06312</td>
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<td>2002</td>
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<td>0,73090</td>
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<tr>
<td>2003</td>
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<td>0,79402</td>
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<tr>
<td>2004</td>
<td>306</td>
<td>1,01661</td>
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<tr>
<td>2005</td>
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<td>0,88372</td>
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<tr>
<td>2006</td>
<td>305</td>
<td>1,01329</td>
</tr>
<tr>
<td>2007</td>
<td>307</td>
<td>1,01993</td>
</tr>
<tr>
<td>2008</td>
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<td>0,61130</td>
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<tr>
<td>2009</td>
<td>153</td>
<td>0,50831</td>
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</table>

The population sizes are retrieved from Europa (2010).
<table>
<thead>
<tr>
<th>Year</th>
<th>M&amp;A</th>
<th>Percentage change</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>129</td>
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<tr>
<td>2001</td>
<td>153</td>
<td>18.60%</td>
</tr>
<tr>
<td>2002</td>
<td>145</td>
<td>-5.23%</td>
</tr>
<tr>
<td>2003</td>
<td>179</td>
<td>23.45%</td>
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<tr>
<td>2004</td>
<td>263</td>
<td>46.93%</td>
</tr>
<tr>
<td>2005</td>
<td>236</td>
<td>-10.27%</td>
</tr>
<tr>
<td>2006</td>
<td>177</td>
<td>-25.00%</td>
</tr>
<tr>
<td>2007</td>
<td>240</td>
<td>35.59%</td>
</tr>
<tr>
<td>2008</td>
<td>195</td>
<td>-18.75%</td>
</tr>
<tr>
<td>2009</td>
<td>231</td>
<td>18.46%</td>
</tr>
</tbody>
</table>