

# FINANCIAL SERVICES M&A: TIME FOR RUSSIA



In the current economic upswing, consolidation is one of the important issues in the Russian financial services market, where approximately 1,300 banks now operate: nevertheless, argue **Alexandre Gorine**, Managing Director of the Moscow office of Accenture, Partner, and **Andrea Bargioni**, senior manager, Department of Finance services, M&A transactions are not sustainable over the long term if value is not created for the shareholders of the banks involved

**Synergies in banking integration stem** from different areas of the value chain (e.g. commercial offer/product catalogue extension, alignment to best commercial practices, personnel and operating costs savings, capital management synergies) and top performers – especially in quickly growing markets – can achieve synergies of up to 15% in higher revenues and 20% in lower costs. Accenture's experience in the banking field suggests a few key issues for successfully managing M&A deals: a comprehensive due diligence, the ability to quickly take the 'tough decisions' (e.g. key management positions), a dedicated integration management structure and a very pragmatic/value led approach are of foremost importance. We also believe that in big transactions, IT is a key enabling factor for a successful integration and, in this respect, setting up a proper 'acquisition/migration engine' to retain and leverage on acquired assets and skills is fundamental.

## Call for consolidation

The Russian banking market is currently undergoing a phase of very quick transformation:

- corporate and retail segments of banking assets and liabilities have been growing at an unprecedented pace over the last three years (approximately ten per cent and above), although peri-

odically threatened by rumours on the financial equilibrium and stability of some players;

- demand from customers is reshaping, shifting to new products and to new distribution channels.

In this context, it is not only the economic rationale, but also the Central Bank of Russia which is raising the consolidation issue in the country's banking sector. Many sources report that in a sound future scenario the national banking system could have five to ten major banking institutions operating in Russia and outside, about 20-30 medium sized banks active in the CIS area, and roughly 100 specialised players covering Russia; this is after all a scenario which applies to several Western and Central European banking markets, developed and developing.

Russian players are already moving in this direction – e.g. recent deals like the Interros Holding (Rosbank) takeover of the OVK Banking Group, the Nikoil Financial Corporation 15% stake acquisition of Uralsib Bank, the recent transactions by VTB (Promstroy Bank, Guta Bank) and IFD Kapital (Petrocommerce Bank) – though we believe the game is 'just starting up'. Further evidence is supported by growing transparency on the market and the increasing involvement of reputable advisors for the pre- and post-deal phase.

## M&A: value creation or destruction?

M&A deals in banking occur as a result of a variety of strategies:

- geographic growth, to gain market share of new local/national markets;
- product range extension (or completion), taking over specialised niche players with strong positions in specific market segments;
- achievement of scale/ scope economies;
- defensive actions aimed at protecting one bank's client base or at replicating the market leader's strategy.

All the above mentioned rationales apply to the Russian market.

Whatever the specific strategy, M&A transactions are hardly sustainable over the long term if value is not created for the involved banks' shareholders. Value creation must be placed at the core of any banking acquisition/ merger, though this target is frequently missed due to the intrinsic complexity of efficiently integrating different financial institutions; this is probably one of the reasons why, so far, many Russian players have preferred to build their presence in new areas/segments through internal growth strategies rather than through acquisitions.

Nevertheless, evidence from Western

Table 1 – Synergy sources

AREA		ACTIONS	RATIONALE
REVENUE SYNERGIES	Commercial offer/ product catalogue extension	Direct funds raising/ payment services	<ul style="list-style-type: none"> <li>Completing/ updating product catalogues</li> </ul>
		Credit products	<ul style="list-style-type: none"> <li>Extend loans catalogue for retail clients</li> <li>Review loans catalogue for corporate clients</li> </ul>
		Indirect funds raising/ bancassurance	<ul style="list-style-type: none"> <li>Completing/ updating product catalogues/ cross selling</li> <li>Pricing guidelines optimisation</li> </ul>
Alignment of group wide commercial performances	Commercial methodologies	<ul style="list-style-type: none"> <li>Customers targeting/ segmentation</li> <li>CRM models</li> </ul>	
COST SYNERGIES	Personnel and operating costs synergies	Purchasing/ sourcing	<ul style="list-style-type: none"> <li>Purchasing power optimisation</li> <li>Stronger negotiation power against suppliers</li> </ul>
		Information Technology	<ul style="list-style-type: none"> <li>Outsourcing/ Applications integration / Facility Management</li> </ul>
		Back office activities	<ul style="list-style-type: none"> <li>Integration of back office operations</li> </ul>
		Product factories	<ul style="list-style-type: none"> <li>Product factories integration</li> </ul>
		Real estate	<ul style="list-style-type: none"> <li>Real estate management optimisation (property &amp; facility)</li> </ul>
		Training	<ul style="list-style-type: none"> <li>Training centralisation/ optimisation</li> </ul>
	Capital management synergies	Credit rating	<ul style="list-style-type: none"> <li>Cost of funding improvement (alignment to group wide credit rating)</li> </ul>
		Funding	<ul style="list-style-type: none"> <li>Funding needs optimisation</li> </ul>
		Capital management	<ul style="list-style-type: none"> <li>Share capital rightsising</li> </ul>

Source: Accenture analysis

European and international markets proves that successful acquisitions/ mergers can, over a two to three year time span, generate significant excess returns (+20/30%) to shareholders compared to average transactions. The challenge then becomes to successfully structure and manage 'win – win' deals.

### Synergies generation

Synergies generation is the key driver for achieving long-term, sustainable value creation; the market perception of such an issue in M&A transactions is of foremost importance, and puts increasingly competitive pressure on banking players for successful deal management.

Synergies in banking integration stem from different areas of the banking value chain: benefits can arise from the revenue as well as from the cost side (see Table 1).

As the Russian market for banking M&A evolves, synergies generation benchmarks will increasingly be available. Anyhow, it is possible to rely on Western European standards to have an approximate idea of what markets should expect from an acquisition/ merger in the financial services sector (and thus what the banks' management involved in steering such transactions will be required to deliver).

Table 2 shows a sample of major M&A

transactions which have on Western European markets over the past five years, and displays synergies identified by the involved banks. Synergies targets vary across countries, nevertheless, we believe such targets can be viewed as a reasonable base threshold for Russian banks engaging in M&A deals. 'Mergers of equals' (ie. transactions among financial institutions with a comparable size) and 'Pure acquisitions' (ie. transactions where the buyer has a much greater size compared to the target) are distinguished, as the size of the involved banks factors significantly on synergies generation: on average, the analysed transactions yielded:

- revenue synergies (increase in revenues) as large as three to four per cent of the aggregated new bank revenue base;
- cost synergies (decrease in costs) as large as five to six per cent of the aggregated new bank cost base;
- total synergies (revenue and costs) on aggregated total assets in the region of 20-30 basis points.

Top performers, especially if active in quickly growing economies, can manage to achieve 15% synergies on revenues and 20% synergies on costs. The relative balance between cost and revenue synergies is roughly equal, though it must be remarked that in general financial analysts tend to judge cost

synergies the more credible as the involved bank have full levers to impact and cut such P&L items.

### Recipe for success

The reasons behind the success/ failure in an M&A deal differ significantly from case to case.

The Accenture experience in the banking field has highlighted a few key areas for the successful management of M&A deals:

- during the pre-deal phase it is of foremost importance to execute a comprehensive due diligence, ranging from financials, to strategic fit, to HR/ cultural fit, to legal issues; poor due diligence drawbacks can be extremely expensive and difficult to tackle as the transaction is in place;
- once the deal is done, we believe the top management of the new combined entity coming from the merger has to quickly take the 'tough decisions' (e.g. other management positions, locations selection) in order to have, as soon as possible, a clear hierarchic context and a strongly committed team, working on the day-to-day issues as well as supporting the integration; the first '100 days' are fundamental to a successful integration;
- a pragmatic approach to integration is extremely important: the most value accretive activities should be performed with the highest priority

Table 2 – Synergies achieved on Western European financial institutions M&amp;As Data in %, 1999-2004

DEAL	'MERGERS OF EQUALS'					'PURE ACQUISITIONS'							AVG all deals
	Transaction #1	Transaction #2	Transaction #3	Transaction #4	AVG 'Merger of equals'	Transaction #5	Transaction #6	Transaction #7	Transaction #8	Transaction #9	Transaction #10	AVG 'Pure acquisitions'	
Break-up													
Revenue synergies as a % of total	57%	48%	32%	48%	50%	63%	57%	48%	32%	48%	50%	63%	57%
Cost synergies as a % of total	43%	52%	68%	52%	50%	37%	43%	52%	68%	52%	50%	37%	43%
Total synergies	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Key ratios													
Total synergies/ Total assets	0,3%	0,4%	0,3%	0,8%	0,4%	0,2%	0,1%	0,1%	0,1%	0,1%	0,1%	0,1%	0,2%
Total synergies/ Total revenues	7,8%	11,3%	7,6%	18,0%	11,1%	4,2%	1,3%	1,9%	4,1%	3,8%	4,8%	3,4%	6,2%
Revenue synergies/ Total revenues	4,4%	5,4%	2,4%	8,5%	5,2%	2,7%	0,6%	1,2%	1,9%	2,1%	2,5%	1,9%	3,1%
Cost synergies/ Total costs	5,4%	10,0%	9,0%	12,9%	9,3%	2,6%	1,2%	1,1%	4,1%	2,9%	3,7%	2,6%	5,2%

Source: Accenture analysis on companies data, analyst presentations

and in parallel, leaving the less urgent issues to a later stage; for instance, a number of 'quick win' projects should be launched right away, addressing the most sizeable sources of value for the bank and its shareholders (e.g. sourcing optimisation, cross selling of new killer products, effective capital management, infrastructure/ IT synergies);

- handling the post-deal phase is a very complex topic: we suggest it should be addressed by setting up a dedicated Programme/Integration Management structure, that has special methodologies and tools for: risk assessment, based on similar projects; integration activities planning; integration activities organisation, execution and monitoring; current result analysis and – whenever needed – integration process corrections;

- in big transactions, IT is a key enabling factor for a successful merger or acquisition: this entails integrating – for the front and back end – the application and facility management as well as the development function, in order to allow the new bank to rely as quickly as possible on the same platform (and thus to speak the 'same language'). In our experience, the

importance of this issue is frequently underestimated. In this respect we see as critical: assessing the different technological platforms and the different existing applications; quickly defining the target system and the IT platform to be migrated; clearly defining the IT integration strategy – including the management of the interim phase – and effectively estimating costs and timing; understanding the different integration areas for the existing applications, assessing – whenever possible – opportunities for improvement; executing a comprehensive capacity planning; effectively running the 'conversion' to the target system;

- for quickly growing banking groups – engaging in multiple acquisitions – 'experience curves' in managing the integration of different financial companies are evident; setting up a proper 'acquisition/ migration engine' structure to retain, accumulate and leverage on acquired skills is fundamental. We believe it is extremely important that the resources involved in these 'acquisition/ migration engine' structures can rely on: relevant integration skills, gained through the exposure on previous similar transactions; strong internal visibility;

strong sponsorship from the top management.

Our experience shows that the creation of such 'acquisition/ migration engine' structures – right from the beginning – significantly reduces risks and costs for the following M&A deals, generating advantages for the management as well as for the shareholders of the banks. Moreover, we believe financial analysts positively view the creation of such structures, while evaluating the credibility of declared value creation targets.

Accenture, based on a wide exposure on several M&A pre and post deal engagements, has developed a comprehensive methodology to successfully create an 'acquisition/ migration engine' structure, employing specific assets to provide an integrated approach and to orchestrate business strategies, business processes, information technologies and personnel issues. These specialised assets/tools (e.g. the M&A Workbench – providing relevant benchmarking values and KPIs, the M&A Planning Guide, the M&A Risk Analysis Tool) are usually exploited by project teams to avoid mistakes and reduce risks and integration timeframes. 