

M& A In the Banking Industry - Suitability and Complementarity of Business Strategy as Drivers to Improve Synergy Realization

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Abstract: While facing accelerating consolidation and an increasing number of mergers and acquisitions (M&A) in the banking industry in Germany, there is evidence that in a significant number of cases, the expected synergies have not been achieved after the M&A integration projects. An important reason is an insufficient focus on the suitability and complementarity of the target and the bidder's business strategies in the context of synergy realization of M&A transactions. Although there may be a macro-level understanding in the current research, this study is designed to provide deeper insights into the degree of strategic cost and product orientation, external relatedness concerning target markets, combination potential, and entrepreneurial orientation, which maximizes synergy realization and reduces corresponding failure rates. This study relies on a sample of 263 online survey responses from M&A transactions of the banking industry in Germany, including cross-border transactions. The research strategy follows a quantitative approach, an empirical study with primary data gathered from an online survey with experienced M&A project and change managers. The study is highly relevant for both the academic world as well as decision-makers responsible for M&A transactions, as the results provide an in-depth understanding of synergy realization to gain new insights and improve M&A success rates, while differentiating and looking at the specifics of the German banking groups including cross-border M&A transactions.

Keywords: *M&A, mergers & acquisitions, M&A synergy realization, Business suitability, M&A complementarity*

I. Introduction

While facing accelerating consolidation and an increasing number of mergers and acquisitions (M&A)¹ in the banking industry in Germany (EBF, 2019; EBF, 2020), there is evidence that in a significant number of cases, the expected synergies have not been achieved after the M&A integration projects (Marks & Mirvis, 2001; Vennet, 2003; Papadakis, 2005; De Long & De Young, 2007; Papadakis & Thanos, 2010; Correa, 2009; Lau et al., 2012; Rothenbücher et al., 2012; Bauer & Matzler, 2014; Osarenkhoe&Hyder, 2015; Homburg & Bucerius; 2016; Sinn & Thoben, 2019). Only 64.81% of respondents in the online survey of this study state that the individual M&A transaction they were involved in showed an increase in return on investment, equity, and sales. An important reason is an insufficient focus on the suitability and complementarity of the target and the bidder's business strategies in the context of realizing synergies in M&A transactions (Vieru & Rivard, 2015; Kovala & Skok, 2014; Öberg & Tarba, 2013; Carretta et al., 2015; Bauer & Matzler, 2014; Homburg & Bucerius, 2006; Papadakis, 2005). Wadhwa and Syamala (2015) pointed out that the efficiency theory had only been empirically validated with reservation in this context. Although there may be a macro-level understanding in the current research, this study is designed to provide deeper insights into the degree of strategic cost and product orientation, external relatedness concerning target markets, combination potential, and entrepreneurial orientation, which maximizes synergy realization and reduces corresponding failure rates. Therefore, the study analyzes the following research question:

How do suitability and complementarity of the business strategy of the target and the bidder affect synergy realization of the M&A transaction in the German banking industry?

¹This study uses the term M&A for mergers and acquisitions and the terms mergers and acquisitions interchangeably. Moreover, the term takeover is also used interchangeably, following relevant sources (Brealey et al., 2001; Weber & Drori, 2011).

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II. Literature review

Within the increasing number of M&A research studies and increasing complexity, the Strategic-Management-School is considered as the relevant school of thought for this research paper. The Strategic-Management-School explores the question of whether companies can gain sustainable competitive advantages and thus realize synergies and increases in value in the long run through M&A transactions (Bauer, 2012; Kim & Finkelstein, 2009; Birkinshaw, 2000; Haspeslagh & Jemison, 1991). This school's focus is on strategic fit, degree of relatedness, strategic complementarity, and combination potential (Bauer, 2012; Kim & Finkelstein, 2009; Ramaswamy, 1997). The underlying M&A Motive Theories teach that M&A transactions are initiated for certain reasons, according to the Efficiency Theory as one of them, to achieve synergies in terms of economies of scale and scope (Bauer, 2012; Trautwein, 1990; Jansen, 2008; Bösecke 2006; Trautwein, 1990; Wadhwa & Syamala, 2015; Bauer & Matzler, 2014; Zhou, 2011; Feix, 2020). M&A transactions between companies with similar strategic characteristics achieve higher synergies according to the Strategic Similarities Theory (Bauer, 2012; Larsson & Finkelstein, 1999; Ramaswamy, 1997; Kim & Finkelstein, 2009; Shelton, 1988; Singh & Montgomery, 1987; Porter 1980; Altunbas & Marques Ibanez, 2004). According to the Resource-Based View, unique resources and synergies between buyer and target company lead to an increase in performance (Ramaswamy, 1997). Relevant studies (Bauer & Matzler, 2014; Homburg & Bucerius, 2006) support that a similar strategic orientation, the bidder and the target firm's orientation on costs and products before the merger or acquisition are in line, is positively associated with synergies realized through the M&A transaction. Further drivers positively related to the synergy realization of M&A transactions are relatedness to target markets (Homburg & Bucerius, 2006; Capron & Hulland, 1999), combinational potential (Larsson & Finkelstein, 1999), and entrepreneurial orientation (Engelen, 2010).

III. Research deficits

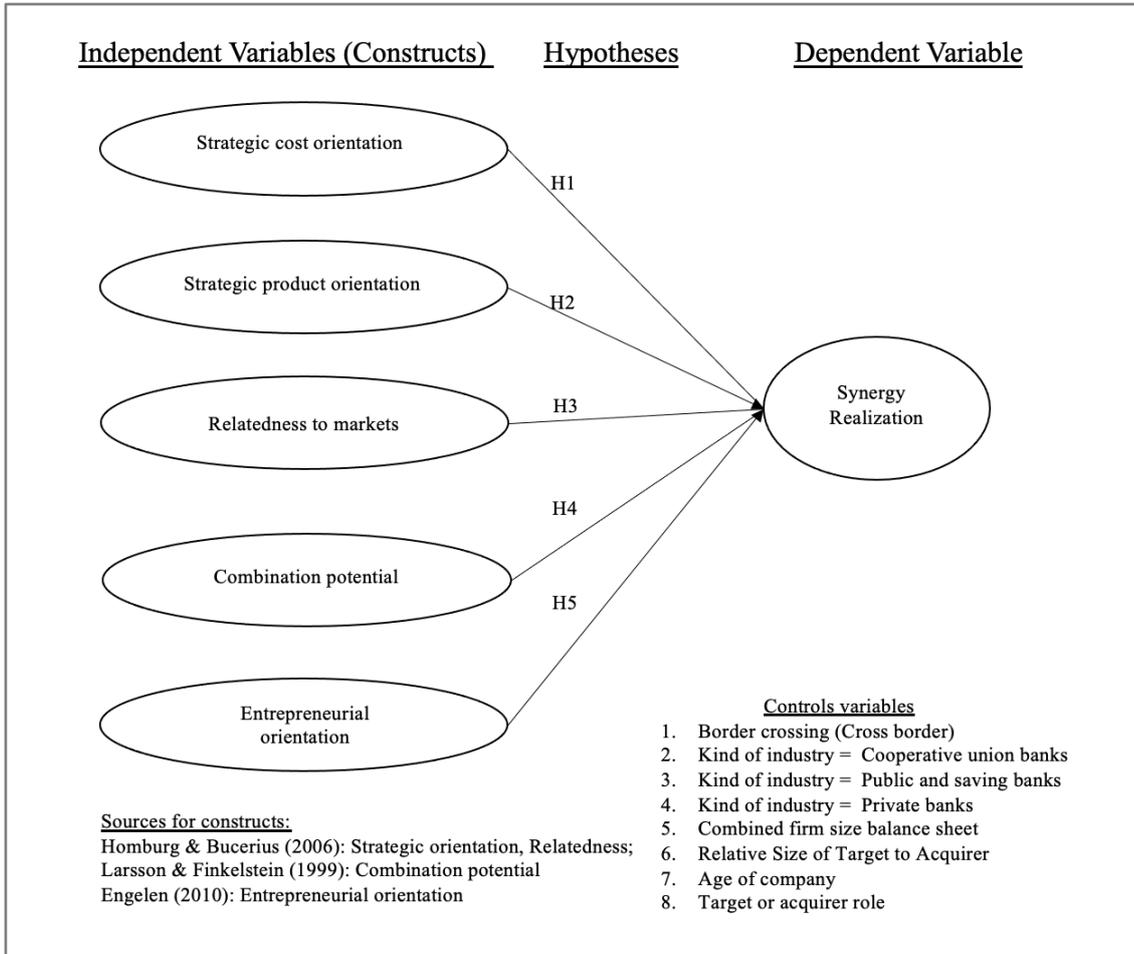
First, the relationship between suitability and complementarity of the business strategy and the synergy realization of M&A transactions is still understudied. An in-depth understanding is still lacking how suitability and complementarity of the business strategy of the target and the bidder affect the synergy realization of the M&A transaction in detail, including optimization of PMI related synergy realization break-even-points and how failure rates can be reduced. This is supported by a significant number of research calls on validating and detailing existing theories and literature streams (Vieru & Rivard, 2015; Kovala & Skok, 2014; Öberg & Tarba, 2013; Carretta et al., 2015; Bauer & Matzler, 2014; Homburg & Bucerius, 2006; Papadakis, 2005). Second, research has not focused sufficiently on the specifics for individual industries like banking in a specific country like Germany despite of the corresponding unique aspects, so that the empirical validity of the relevant relationships in detail is still lacking (Kovala and Skok, 2012; Dunlap et al., 2016; Carretta et al., 2015). Third, specific new drivers are forcing M&A deals in the German banking industry. In addition to well-known factors, new regulations, technological developments, and digitization also require companies to enter into M&A deals and consolidation (Beitel, 2002; EBF, 2019). Fourth, M&A research to date has focused too much on large transactions, medium, and small transactions, and companies are neglected. The reason is often that medium-sized and smaller relevant companies are not listed on the stock exchange, and often only little data is publicly available. Nevertheless, research into small and medium-sized M&A transactions should provide important new general insights (Bauer, 2012; Jansen, 2008; Huhtilainen et al., 2021).

IV. Research Model

The research model has been designed with synergy realization as the Dependent Variable (DV), and five Independent Variables (IVs) supposed to cause an effect or change on the DV. Based on the relationships of each IVs with the DV, five hypotheses (H1-H5) have been defined as shown in **Figure 1**. Eight Control Variables (CVs) have been identified (Colombo & Rabbiosi, 2014; Homburg & Bucerius, 2006). The CVs are supposed to influence experimental results and are held constant during the online survey to analyze the relative relationship of the DV and IVs. Well-established constructs and measurement scales from highly ranked, peer-reviewed journal articles have been applied to empirically verify hypotheses and the conceptual model. To measure the strategic cost and production orientation of both concerned companies before the M&A transaction, constructs following Homburg and Bucerius (2006) were used, asking the participants, for example, to which extent both companies focused on the achievement of economies of scope and scale, standardization of products and services, achievement of a leading product and brand image, and positioning

in the premium price segment. External relatedness to markets of the concerned companies was measured with a further construct from Homburg and Bucerius (2006), and a construct assessing the combination potential between the two involved companies, covering production similarity, production complementarity, marketing similarity, and marketing complementarity, was taken from Larsson and Finkelstein (1999).

Figure 1: Conceptual Model with Corresponding Variables and Relationships



Source: Own illustration by the author

For the evaluation of the entrepreneurial orientation, a construct concerning proactivity, risk-taking, and innovativeness, according to Engelen (2010), was applied. To measure the dependent variable synergy realization, a construct based on Larsson and Finkelstein (1999) was used, in which the participants were asked after their assessment of individual realized M&A advantages such as cost efficiency through the consolidation of production, marketing, administration, purchasing, transfer, and know-how. How-building, increasing market power, access to markets and customers, cross-selling and joint sales. Two new items have been added by the author to account for new drivers and the corresponding synergies concerning new regulations, technological development, and digitization.

V. Research Design

This study relies on a sample of 263 online survey responses from M&A transactions of the banking industry in Germany, including cross-border transactions. A quantitative-empirical approach was applied considering the individual phases of the research process pursuant to the relevant standards (Döring & Bortz, 2016; Kovela & Skok, 2012; Kanuk & Berenson, 1975). The gathered primary data for the multiple regression analysis and structural equation model (SEM) was subject to the common standard principles and controls, including avoiding non-response bias, common method bias, and multicollinearity (Kovela & Skok, 2012; Kanuk & Berenson, 1975). The Qualtrics platform was used for the online data collection for submitting answers and completion of questionnaires by respondents, and as a central collection of completed questionnaires and upload of data to Stata®16.1 for further statistical processing (Kline, 2016). Exploratory factor analysis (EFA) was initially conducted to assess the factor structure resulting from the items without consideration of a priori theory using maximum likelihood extraction (Treiblmaier & Filzmoser, 2010).

Confirmatory Factor Analysis (CFA) was applied to analyze whether measures of a construct are consistent with a researcher's understanding of the constructs and their items and whether the data fit a hypothesized measurement model (Kline, 2016; Joereskog, 1969). CFA was also conducted with and without a Common Latent Factor (CLF), onto which all latent constructs' items were loaded to verify and evaluate if any data were subject to common method bias (Podsakoff et al., 2012). Reliability verifications with Cronbach's alpha (α) and Composite Reliability (CR) justified the usage of constructs as well (Döring and Bortz, 2016; Kline, 2016; Strese et al., 2016; Bagozzi, Yi, & Phillips, 1991). Convergent validity and discriminant validity could be verified (Fornell & Larcker, 1981; Bagozzi et al., 1991). Measurement scale details are shown in **Table 1**.

Table 1: Measurement Scales

Constructs	α	CR	AVE	VIF (Mean: 2.48)	Mean (unstandardized)	SD (unstandardized)
Strategic costorientation	0.9008	0.8959	0.6832	3.35	4.7900	1.7678
Strategic productorientation	0.8589	0.8391	0.6356	2.84	4.2010	1.8672
Relatednesstotargetmarkets	<i>This is only reported when there are more than two items, according to Homburg & Bucerius (2006).</i>			1.35	4.1781	1.8884
Combination potential	0.8356	0.8239	0.5398	1.63	4.7835	1.5694
Entrepreneurialorientation	0.9368	0.9358	0.5229	1.42	3.1855	1.3888

Source: Author based on Stata calculations

The analysis of the significance of the hypothesis statements was conducted with multiple regression analysis. Furthermore, covariance-based Structural Equation Model (SEM) using Maximum Likelihood for Missing Values (MLMV) method was applied for simultaneous estimation of multiple, interrelated dependence relationships and the analysis of constructs within one single model containing the whole set of relationships (Hair et al., 2010).

VI. Findings

While the baseline model shows an R-squared value of 0.119 (Adjusted R-squared value = 0.084; F-value = 3.34, $p = 0.001$ at the 99% level, the regression analysis on the model considering the five defined independent variables and eight control variables, yields an R-squared value of 0.692 (Adjusted R-squared value = 0.667; F-value = 28.28; $p = 0.001$ at the 99% level). Considering those indicators and the previously mentioned robustness checks allows to confirm a good model. Individual variables' behavior does not reveal any inconsistencies. Therefore, this model is deemed as appropriate to be used for multiple linear regression analysis. **Table 2** provides the detailed regression results of the hierarchical regression approach, whereby all independent and control variables are considered. The Baseline Model (1) includes the regression of the control variables with synergy realization only, the other models are showing explicitly the independent variables. It needs to be noted that the first row of each variable shows the coefficient of determination, the second row shows the standard error, that the level of significance is shown as * $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$ (two-tailed test).

With the verification of Hypothesis H1, the positive association between strategic cost orientation with the realization of synergies is supported ($\beta = 0.591, p = 0.000$). Hypothesis H2 is also supported ($\beta = 0.148, p = 0.069$) so that the similarity between the business strategy of the target and the bidder in respect of strategic product orientation is positively associated with the realization of synergies. Hypothesis H3 concerning external relatedness regarding target markets is not verified to be significant ($\beta = -0.017, p = 0.819$). With Hypothesis H4, the combination potential of the involved companies in respect of marketing and product(ion) is supported to be positively associated with the realization of synergies ($\beta = 0.228, p = 0.000$). In contrast, with Hypothesis H5, the positive association between proactive, risk-taking, and innovative entrepreneurial orientation of the involved parties with the realization of synergies – was not supported ($\beta = -0.011, p = 0.838$).

The regression results on inverted U- and S-shaped pattern were overall mixed (Yerkes & Dodson,1908). While significance for an inverted U-shaped pattern with quadratic terms was supported for the coefficients for strategic orientation on cost as well as for strategic orientation on product, however, the other required conditions recommended by the three-step-verification-procedure confirming that also the coefficient slope is sufficiently steep at both ends of the data range and turning point located well within the data range suggested by relevant studies were not met (Haans& Zi-Lin, 2016; Lind &Mehlum, 2010). The dedicated regression analysis purely on private bank industry group as well as on domestic transaction revealed independently from each other that in contrast to the entire dataset, the variable strategic orientation on product is not significantly associated with synergy realization, while strategic orientation on cost and combination potential remain significant. The validation of the hypothesized relationships by means of a covariance-based SEM using the MLMV method (Kline, 2016; Wolf et al., 2013; Zhao et al., 2010; Preacher & Hayes, 2004) support the robustness of the model and the findings from the regression analysis.

Table 2: *Regression Results of Hierarchical Regression Approach*

Independent and Control Variables	Baseline Model (1)	Model (2)	Model (3)	Model (4)	Model (5)	Model (6)
Strategic costorientation		0.814*** (0.0502)	0.668*** (0.0795)	0.670*** (0.0811)	0.568*** (0.0830)	0.591*** (0.0842)
Strategic productorientation			0.191** (0.0816)	0.190** (0.0821)	0.173** (0.0793)	0.148* (0.0810)
Relatednesstotargetmarkets				-0.008 (0.0716)	-0.021 (0.0692)	-0.017 (0.0753)
Combination potential					0.223*** (0.0608)	0.228*** (0.0609)
Entrepreneurialorientation						-0.011 (0.0539)
Observations	206	180	180	180	180	178
R-squared	0.119	0.652	0.663	0.663	0.688	0.692
R-squared Adj.	0.084	0.634	0.643	0.641	0.666	0.667
p (Prob > F)	0.001	0.000	0.000	0.000	0.000	0.000
F	3.34	35.41	33.25	30.05	30.72	28.28

Source: Author based on Stata calculations

VII. Limitations

Executing future studies on the scope of this research paper across a more extended period with more than one observation point of time for each respondent could enable an in-depth analysis of potential dynamic effects. Moreover, further refinement of this study could be achieved using qualitative data through interviews with managers from organizations practicing M&A transactions or more dedicated research work on dedicated bank groups like private and public banks. The inverted U- and S-shape analysis should be extended using further appropriate datasets. The author of this study managed to provide evidence for the significance of the coefficients but failed to fulfill the entire three-step-verification-procedure recommended by Lind and Mehlum (2010). However, the study conducted by Haans et al. (2016) with 110 *Strategic Management Journal* articles identified only a single study (Fernhaber& Patel, 2012) that managed the formal verification of invested U-shape by following all the steps recommended by Lind and Mehlum (2010). This provides a further avenue for future research to improve the accuracy of the empirical analysis (Haans et al., 2016) and precisely measure the turning point of such relationships facing economic and statistical importance.

VIII. Contributions

This research paper's target is to provide empirically validated answers to the research question "How do suitability and complementarity of the business strategy of the target and the bidder affect synergy realization of the M&A transaction in the German banking industry?". The findings contribute to existing research and the identified research deficits in the following ways. First, the relationship between suitability and complementarity of the business strategy and the synergy realization of M&A transactions was subject to an in-depth analysis following an empirical-quantitative approach. The results support overall that the degree of suitability and complementarity between the business strategy of the target and the bidder, measured in terms of strategic orientation on cost and product and combination potential, is positively associated with the realization of synergies. This is in line with relevant previous studies (Homburg & Bucerus, 2006; Ramaswamy, 1997; Capron & Hulland, 1993, Datta et al., 1992; Datta, 1991), but has

not been empirically validated for the specific scope covered by this research paper. Therefore, second, the contribution becomes even more valuable once all the three banking group pillars in Germany with their specifics are considered as well as German domestic bank M&A transactions and cross-border transactions with Germany as the anchor. In fact, the hypothesis, the higher the degree of business strategy suitability and complementarity, measured by strategic orientation on cost and product and combination potential), the higher realized synergies, is supported. In contrast to Homburg and Bucerius (2006) but in line with Shelton (1988), the presented study could not reveal evidence that relatedness concerning target markets is significantly associated with synergy realization. The study could not find evidence that proactive risk-taking and innovative entrepreneurial orientation of the involved parties significantly supports the realization of synergies as proposed by Engelen (2010). While this may be a supporter for the success of start-ups or growing companies, this obviously is not a significant driver for the integration of two banks. Third, two news items have been added by the author to the DV construct to account for new drivers and the corresponding synergies concerning new regulations, technological development, and digitization. Fourth, this research paper analyzed all M&A transactions between German banks identified between 2007 and 2017, including cross-border transactions in which at least one bank involved was based in Germany, regardless of size, stock exchange listing, legal entity, and ownership. 263 online survey responses from M&A transactions in the banking industry in Germany, including cross-border transactions, are therefore included in the quantitative-empirical analysis of the research deficit, which has so far concentrated on large-scale transactions with listed companies. This helps to gain important new general insights into M&A transactions (Bauer, 2012; Jansen, 2008; Huhtilainen et al., 2021).

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