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TRENDOVI U POSLOVANJU
NAUČNO-STRUČNI ČASOPIS

THE IMPACT OF THE COVID-19 PANDEMIC ON TRENDS IN THE EUROPEAN BANKING SECTOR

UTICAJ PANDEMIJE COVID-19 NA TRENDOVE U EVROPSKOM BANKARSTVU

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Abstract

This article gives a summary of key developments in the European banking industry before and during the global financial crisis, with a focus on trends following the COVID-19 pandemic outbreak. The purpose is to provide an overview with conclusions on the European banking sector's actual and upcoming trends following the COVID-19 pandemic, based on scientific research and reports from selected international financial institutions. The crisis brought on by the COVID-19 pandemic has accelerated the global consolidation process and the advancement of financial technologies, particularly in European banks. In light of the financial crisis' uncertainty and the widespread use of "lockdown" measures, banks in Europe launched a race to digitalize business activities. Banks will also increasingly utilize mergers and acquisitions as a strategy for business model change as competition heats up in the market. However, European banking is undergoing a transformation driven mostly by technological advances. This is both for financial reasons and to stay relevant in the highly competitive digital banking landscape. Green finance are also becoming increasingly popular as a means of promoting environmental sustainability.

Sažetak

U članku se daje pregled ključnih trendova u evropskom bankarstvu u periodu pre i nakon globalne finansijske krize, sa akcentom na trendove nakon izbijanja pandemije COVID-19. Cilj je da se pruži pregled sa zaključcima u vezi sa pomenutim aktuelnim i nadolazećim trendovima na osnovu naučno-istraživačkih članaka i izveštaja odabranih međunarodnih finansijskih organizacija. Kriza izazvana pandemijom COVID-19 uticala je na ubrzanje procesa konsolidacije i razvoja finansijskih tehnologija na globalnom nivou, a posebno u bankama u Evropi. Pod uticajem neizvesnosti u finansijskoj krizi, a imajući u vidu široko korišćenje mera ,,zatvaranja", banke u Evropi počele su da se utrkuju u digitalizaciji poslovnih aktivnosti. Imajući u vidu sve veću konkurenciju na tržištu, banke u Evropi će sve više da pribegavaju merdžerima i akvizicijama kao strategiji za razvoj poslovnog modela. Ipak, u toku je transformacija Evropskog bankarskog sektora koja je uglavnom pod uticajem tehnološkog napretka iz finansijskih razloga, ali i zbog opstanka u visokokonkurentnom bankarskom okruženju. ,,Zelene" finansije, takođe, postaju u sve većoj meri popularne kao sredstvo za promovisanje ekološke održivosti.

Keywords: *European banking sector, bank mergers and acquisitions, developments in financial technology, innovative banking products and services*

Ključne reči: *evropsko bankarstvo, merdžeri i akvizicije banaka, razvoj finansijskih tehnologija, inovativni bankarski proizvodi i usluge*

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1. Introduction

Financial liberalization and technical advancement played a vital role in the 1990s as the banking industry consolidated significantly in the majority of industrialized countries [2]. The size of organizations had the greatest impact on synergy effects and improved management in continental Europe's financial industry between 1995 and 2001. The global economic crisis in 2008 gained momentum with spillovers on economies around the world, but the United Kingdom, France and Germany banking sectors showed a high level of resilience between 2004 and 2015, unlike the economies in Western Europe, in terms of key economic performance indicators, such as asset values, profitability and levels of risk [4]. Following the financial crisis, financial technology started to grow in numerous nations, albeit with some variation.

However, there has been an uptick in fintech activity since the beginning of COVID-19 pandemic that has affected business models, particularly in banks, with notable regional disparities in development due to the "lockdown" measures and social distancing. Because of the pandemic crisis circumstances, there are currently more banks with digitalized operations and innovative products and services than ever before. For example, neo-bank 4.0 is often driven by cost reduction, efficiency, restructuring of the organization, and innovative digital solutions to meet the demands of clients. Also a new breed of challenger banks is developing, and they have an edge over traditional banks when it comes to offering certain financial services to their customers. As a result, the challenger banks are vying for supremacy in the global banking industry.

To stay afloat in today's market and obtain an advantage in the banking industry, banks are also acquiring small fintech firms to achieve a competitive advantage by outsourcing financial technology expertise and capabilities. Banks also increasingly utilize mergers and acquisitions as a strategy for business model change as competition heats up in the market. Using scientific literature and reports from global financial organizations, the purpose of this article is to synthesize key drivers for banking industry developments in Europe following the emergency of the COVID-19 pandemic, with a brief overview of trends and effects from European banking industry following the global financial crisis in 2008. Also the goal is to draw some conclusions about the above-mentioned tendencies in the forthcoming period.

2. Literature review

European banking sector trends and effects prior to and following the onset of the global financial crisis in 2008

In Europe, bank mergers and acquisitions have typically been successful, resulting in large gains for the shareholders of the acquiring banks. A substantial wave of mergers and acquisitions, as well as market consolidation, have taken place since the late 1990s because of the external environmental issues [23]. European bank mergers and acquisitions between 1998 and 2007 revealed that the target banks' owners gained considerable value through the acquisition. As Rad and Van Beek (1999) discovered, the shareholders of the target bank often got considerable abnormal gains, unlike those of the bidders, in cross-border mergers in Europe [19]. Despite this, researchers discovered that bigger and more efficient bidder banks were more profitable for their owners.

Vallascas and Hagendorff (2011) employed the Merton distance from default model to estimate the probability of default of target institutions in the European bank consolidation process [25]. Mergers did not alter the default risk of target banks, the researchers concluded. In cross-border transactions and deals with modest regulatory scrutiny, mergers of relatively safe institutions nonetheless have a significant impact on boosting default risk. There is also a greater risk of failure after a merger in large entities with complex organizational and procedural concerns. According to the authors' findings, the impact of bank mergers on Europe's banking sector stability remain uncertain.

According to Asimakopoulos and Athanassioglou (2013), most of the value increase in European banking between 1990 and 2004 came through mergers and acquisitions, with shareholders of target banks experiencing significant abnormal returns while shareholders of acquirer institutions experienced relatively negative returns [1]. Based on the findings of the authors, domestic mergers and acquisitions, particularly those involving banks with stock exchange shares, tend to be more effective than cross-border banks or target banks without stock exchange shares.

With a rigorous research of domestic and cross-border consolidations in Europe between 1998 and 2004, Lozano-Vivas et al (2011) came to the conclusion that mergers in the European banking sector were efficient [14]. Although domestic mergers and acquisitions were more numerous than cross-border ones, cross-border entities were more efficient. Uhde and Heimeshoff (2009) found that a concentration of the national banking market impairs the financial stability of European banks, by using bank balance sheets from 1997 to 2005 in the EU-25 [24]. According to the authors, East European banking markets have weaker levels of competition, less chances for diversification, and more financially susceptible state-owned banks.

Before the global financial crisis, European bank mergers and acquisitions were usually successful and primarily took place on the local market, while cross-border entities offered more synergetic benefits. Furthermore, consolidation activities benefitted target bank stockholders more than other parties. Following the 2008 global financial crisis, consolidation efforts among the top institutions slowed and the value of bank merger and acquisition deals in several of the large industrialized economies fell in comparison to prior years [3].

When it comes to eurozone, the decline has been more significant for cross-border contracts than for the domestic ones, suggesting that banks are shifting their attention to local markets while concurrently tightening standards for cross-border transactions. As a consequence of the financial crisis, European banks have shifted their focus to domestic deals. The global financial crisis has had the greatest impact on Europe and the United States, diminishing the assets of the banking system, reducing the number of banks, depleting capital and liquid reserves, and decreasing bank returns on capital.

Figure 1 shows the value of transactions of bank mergers and acquisitions in euro area (domestic and cross-border) and United States from 2001 to 2016.

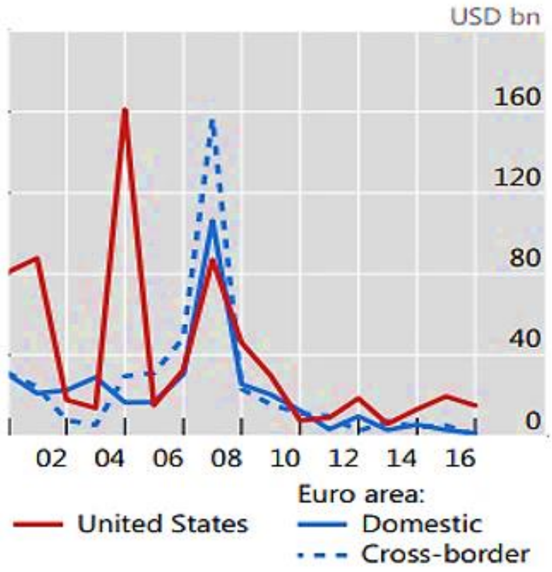

Figure 1. Bank M&A – value of transactions

Source: Bank for International Settlements, 2018, p.14

Key drivers of European banking trends after the onset of COVID-19 pandemic

Since the COVID-19 pandemic crisis, bank merger and acquisition tendencies in Europe have intensified and may continue to do so until 2022, particularly in light of the ongoing crisis and having in mind the uncertainty about how it will evolve in the upcoming period. Despite the challenges facing European banks, the value and volume of mergers and acquisitions of European banks in 2020 have fallen to their lowest level since the global financial crisis [1].

In this regard, the ECB launched a topic related to consolidation transactions, following the publication of the Draft Guidelines for the Consolidation of the Banking Sector in July 2020 and set out expectations regarding the consolidation process in the banking sector related to capital requirements and guidelines, badwill treatment and the new entities' usage of internal models [12].

There are clear differences between countries in terms of the consolidation trend in Europe [16]. Certain large economies, such as Germany, Austria, and Switzerland, offer significant consolidation opportunities because of their diversified and dispersed banking industries. Additionally, banking policy in many countries incorporates segmentation in order to protect certain public or social goals. The total mergers and acquisitions value of European banks fell to less than $ 10 billion in 2018, from about $ 130 billion in 2007 [16].

Figure 2 shows the European countries with the largest number of announced deals related to mergers and acquisitions in 2019 and 2020.

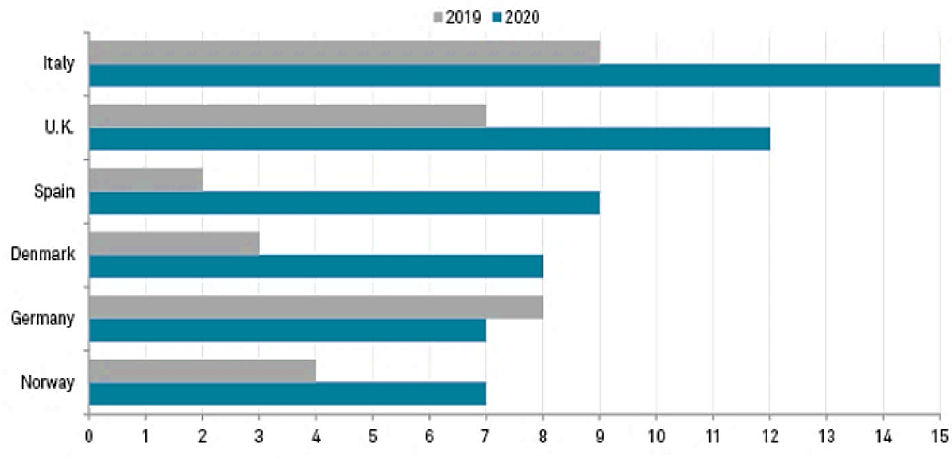

Figure 2. European countries with most announced M&A deals in 2020 (February 4, 2021)

Source: S&P Global Market Intelligence, 2021.

According to KPMG data and in comparison to 2020, in Italy, Luxembourg, Netherlands, Switzerland, Germany, Spain and the United Kingdom, the number of bank consolidated entities grew in 2021, while it stayed steady in Hungary [10]. Italy had the most announced mergers and bank acquisitions in 2020, while Spain achieved the largest year-on-year growth in terms of value of transactions [21]. Spain had the second-highest number of bank branches in the eurozone in 2019, with 49.66 branches per 100,000 people, while Italy ranked third with 38.79 branches, compared to the average of 20.2 branches in the eurozone.

During the last several years, the European bank consolidation process has mostly included domestic or market transactions in which the target bank, buyer, and seller are all located in the same economy. The overall number of bank mergers and acquisitions in Europe in 2021 may surpass that in 2020 with a large percentage of domestic deals [20]. Prior transaction volume is already larger in 2021 than in 2019, and by September 20 it had reached roughly 80% of the amount for 2020. Banks in the Nordic region have signed the most contracts (10), followed by those in Switzerland, Germany, Austria (4 contracts), and Central and Eastern Europe (5 contracts).

According to Scope Ratings, the consolidation trend is continuing apace, with no indications of slowing down in 2022, with a huge share of domestic transactions. Should cross-border agreements occur, the performers are almost certainly large foreign-owned banks that intend to strengthen their presence in key countries through acquisitions.

According to KPMG (2021), Europe's bank consolidation has been fuelled by the following factors [11]:

- Encouraging consolidation by the ECB to address long-term challenges, based on prudential supervision within the due diligence framework.
- Recognition of badwill in order to raise the viability of the combined entity's business model.
- Potential synergy of costs when it comes to streamlining the professional services and branches.
- Potential NPLs that increase the risk of the transaction.
- The lowest interest rates (even after the COVID-19 pandemic) that continue to affect bank profitability.
- The rapid pace of development of technologies in the banking industry, with smaller banks finding it more difficult to continue to follow and invest in financial technologies.

Europe is overbanked - there is one bank per every 82,000 individuals in the European Union. Despite cost transformation programs over the past decade, efficiency ratios have remained above 60% for banks, even before pandemic provisions further affected profitability levels. The weakest banks are particularly concerned about profitability, which has fuelled discussions about consolidation across the sector. This has been made worse by the increase in NPLs as a consequence of COVID-19 and the need to fund and accelerate investments in digitalization and more fundamental changes.

If the European Banking Union progresses, restrictions to cross-border mergers and acquisitions will likely be reduced, which might lead to changes in the European banking industry. As the banking sector changes under the pressure of the global health crisis resulting from COVID-19, banks should pay close attention to the role that consolidation activities play in transforming their businesses [6]. In this way, significant cost rationalization and financing of activities that are crucial for the sustainability of profitability of nowadays banks, related to the development of financial technologies, would be achieved.

European banking is undergoing a transformation driven mostly by technological advances, rather than mergers and acquisitions, caused by widespread usage of "lockdown" and physical distancing measures. Because of the current crisis and, in particular, the low interest rate environment, the challenge for banks will be to retain profitability and market share.

Particularly banks in the United States and Europe are increasingly focusing on the integration of digital technologies into their business operations. The key motive for financial technologies advancement is achieving competitive advantage, so banks should mainly focus on payment and money transfer alternatives to attract customers' attention and meet their expectations, but also to contribute an efficient collection of bank receivables and costs reduction [9].

In high-income economies, banks are the dominant players in the provision of digital financial services, while in lower-income economies, non-banking institutions have more success [13]. In terms of enabling digital advancement, sufficient digital infrastructure and a suitable legal and commercial climate are critical, but poor bank balance sheets might impede such progress.

Table 1 shows the banking industry's challenges and prospects arising from the financial technologies advancement.

Table 1. Threats and opportunities for banking sector arising from FinTech

Areas of influence	Threats	Opportunities
Consumer sector	• confidentiality and data security; • lack of continuity in banking processes; • unacceptable marketing practices.	• provision of highly specialised banking services; • reduction of transaction costs; • acceleration of banking processes.
Banks and banking system	• strategic risks and profitability risks; • increasing the relationship between financial parties; • high operational risk; • third parties management risk; • compliance risk includes the failure of consumer protection and data protection regulation; • terrorism financing risk, money laundering risk; • liquidity risk and banks' financing sources volatility risk.	• improvement and more effective realisation of banking processes • innovative use of data for marketing and risk management purposes; • potential positive impact on financial stability due to increased competition; • RegTech.

Source: Zveryakov, Kovalenko, Sheludko & Sharah, 2019, p. 56

Financial technologies advancement in commercial banks contributes to increasing profitability, innovating financial instruments and improving risk control [26]. Banks can improve their traditional business models through the use of financial technology by reducing bank operating costs, improving service efficiency, strengthening risk control capabilities, and developing better customer-oriented business models, thereby improving overall competitiveness. Fintech company models rely heavily on information technology, with synchronized resources and procedures enabling effective provision of individualized financial services to customers [15].

To meet four new issues that have emerged over the past decade which refer to low-interest rates, stricter regulation, technological innovation and increasing competition from non-banking intermediaries, banks are reexamining their business strategies [22]. The economic shock after pandemic has contributed to the acceleration of financial technologies advancement. In addition, taking advantage of the expanding green market and the creation of new specialized goods and advisory services will certainly be a significant source of profit.

Researchers Collevecchio et al (2021) examined the influence of fintech acquisitions on acquiring banks' performance and discovered that the viability of the acquiring bank, contract parameters, and institutional environment all had an impact on post-deal performance [5]. Banks may also foster sustainable innovation by taking over fintech startups with specific features. Instead of recruiting outside IT specialists, banks might buy fintech companies with a well-coordinated team of experts.

Bank-fintech interaction was studied in detail by Zveryakov et al (2019), who outlined essential bank involvement models in the formation of fintech firms [27]. The authors noted that trends are already changing the economy, especially phenomena such as cognitive economy, sectoral convergence, mobile solutions, cryptocurrencies and decentralized virtual platforms based on blockchain technology. Using possibilities based on financial technology, they concluded that the most successful banks in the future would be those who have modified their business strategies. Banks will have no option but to stay abreast of new financial technologies if they want to remain competitive. As a result, customers will choose banks that provide more efficient and less expensive services.

Consequently, partnership with fintech companies threatens to become a key strategy for banks in the coming period. Because of regulatory issues, banks should take less risk and make investment decisions wiser [17]. According to Kerkhof (2021), bank mergers and acquisitions and fintech startups in Europe have a greater abnormal yield than those in the rest of the globe [7]. Transferwise, Monzo, Starling, Revolut and N26 in Europe have increased their market share almost entirely through customer referrals and network effects, in contrast to traditional marketing approaches [8].

By improving the user experience, startups help to expand their market share and get an edge over their competitors. Subsequently, in the case of bank 5.0, the emphasis is on sustainable banking that takes into account environmental, social, and governance (ESG) criteria and whose decisions are based on the impact of risk, return and the abovementioned ESG criteria [18].

Figure 3 shows bank service digitalization with a comparison by geographic regions.

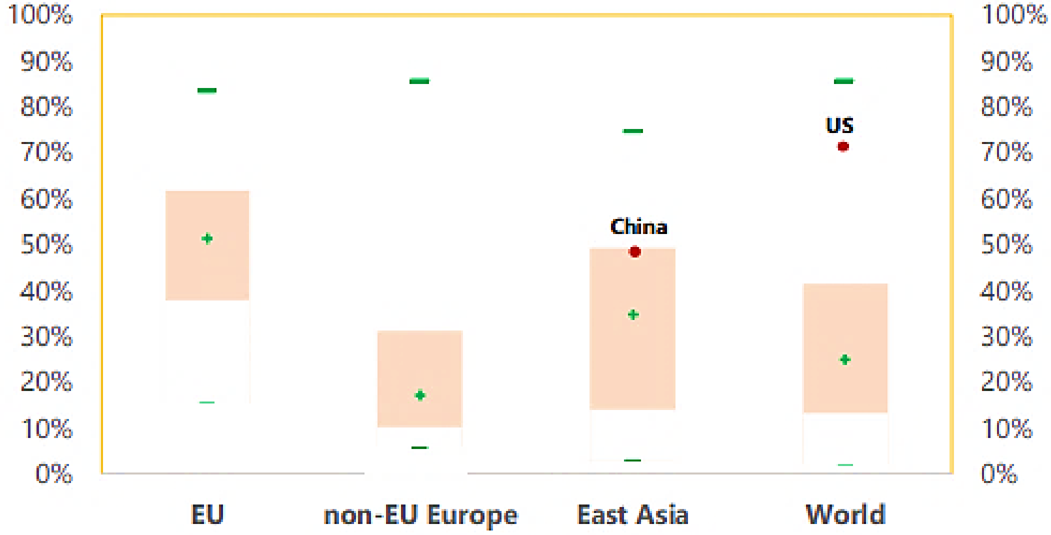

Figure 3. Bank Service Digitalization: A Comparison by Geographic Regions

Source: Liu, M. X, 2021, p. 13 (World Bank Global Findex Database and IMF staff Calculations)

There will be a shift in banking tendencies in Europe after the pandemic because of low interest rates, and increased NPL levels. Consolidation, cost-cutting and increasing rivalry among non-banking intermediaries will be encouraged by these factors, which will also promote customer-oriented business models to flourish. Additionally, the financial industry is becoming more environmentally friendly, with many institutions seeking to implement green lending policies.

3. Conclusion

In the next years, governments throughout the world may expect financial technology innovation to be more significant than traditional measures of economic success, giving contemporary banking a substantial competitive edge. In 2022, we may anticipate the continuation of Europe's banking sectors consolidation and financial technology advancement which is certainly becoming a "conditio sine qua non" for bank survival in a competitive and uncertain crisis environment. Certainly, countries that were more prepared for a global pandemic will undoubtedly take precedence.

As with the global financial crisis, the consolidation process in Europe is projected to be concentrated on the local market. Also banks are attentive in monitoring their business transformation to develop a bank 4.0. Additionally, banks may outsource operations via acquisitions of small fintech startups in order to stay up with changing customer needs, rather than recruiting external information technology professionals. Banks in Europe should use this strategy, having in mind that they have a higher chance of success with fintech startups than banks in the rest of the globe. Banks will aim to adapt their businesses by altering their business models in response to the advent of financial technology.

Following the breakout of the pandemic, two key global banking trends - financial technology advancement as well as accelerated bank mergers and acquisitions activities, stand out and threaten to define the whole year 2022, particularly in Europe. Green finance is also becoming more popular as a means of promoting environmental sustainability. In the next years, European banks will face a variety of challenges, including the pandemic, the rising economic crisis, and the need to embrace and expand financial technology while implementing green policies.

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