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Organisational Structures and the Boundaries of the Firm: Acquisition and Divestment in Financial Services

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INTRODUCTION

The financial services sector has experienced considerable organisational adjustment during the last five years as a result of major legislative changes and increased competitive pressure. One aspect of these changes has been an increase in diversification of product ranges, often effected by acquisition. Of late, a reassessment of these strategies has produced an increase in divestments. These developments highlight the importance of understanding the factors which determine the boundaries of financial services firms. The growing literature on transactions costs provides an important analytical tool in this regard. In essence, the chosen organisational structure and the boundaries between the firm and its markets reflect the need to minimise transactions costs. These transactions costs arise internally through asset specificities and opportunism, and externally through environmental uncertainty, complexity and monitoring difficulties. However, it is important to recognise that organisational structures are dynamic phenomena which evolve as a result of changes in both internal and external conditions that affect the nature and size of transactions costs. Internally, changes in culture, competencies and resources may alter the degree of asset specificity or the extent of opportunism. Alternatively, changes in the external environment will provoke a strategic response and this in turn will often require adjustments to organisational structures.

Empirical developments in this area have tended to concentrate heavily on manufacturing industries and applications in the service sector are limited. However, it can be argued that there are specific features of service firms which, in the context of this analytic framework, will have a considerable bearing on the choice of organisational structure. This paper examines these features in the context of financial services in order

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to explain recent developments in that sector. We present a simple model of the process of organisational change and the factors determining the boundaries between the firm and the market. The following section focuses on the characteristics of the financial services sector and their implications for patterns of organisational change. A review of recent developments in the market for financial services and some evidence on the patterns of mergers and acquisition in the sector is presented.

ORGANISATIONAL STRUCTURE AND THE BOUNDARIES OF THE FIRM

The various approaches towards organisational structures based on the 'transactions costs' model [for example, Williamson, 1975, 1979] seek to explain the development of particular organisational forms according to factors such as asset specificity, transaction frequency and transaction complexity. The transactions cost model emphasises the suitability of internalisation where there are frequent requirements for the specialist application of proprietary knowledge, where physical assets are indivisible, and where there is a lack of trust in complex transactions [Teece, 1980]. In the opposite situation, market relationships would be preferable, while the intermediate case would call for some form of quasi-market arrangement.

Increasingly, a key issue in this literature is the understanding of organisational responses to major internal and external changes. These factors, ultimately, influence the spread of activities owned by a firm and the boundary between internal (hierarchical) and (external) market relationships. In dynamic conditions, firms may need to take action to re-establish the appropriate boundary between these relationships. This in turn may require moves towards greater internalisation through acquisition or alternatively a move towards more market based structures through divestment [Wright and Thompson, 1987].

A simple model of the factors affecting organisational structure and the boundaries of the firm is presented in Figure 1. Internal factors are concerned primarily with culture, corporate tradition, asset specificity and the nature of the production process. These factors do change over time, although the pace of change within the organisation's core is likely to be gradual. Nevertheless, these elements may play an important role in the restructuring process. For example, future strategic developments may be incompatible with existing structures and thus necessitate adjustments in internal organisation and the boundaries of the firm. Rapid change is more likely to be a characteristic of the external environment.

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Sudden changes will alter the 'fit' between the organisation and its environment, provoking a re-examination of strategy and as a consequence of this possible adjustments in the boundaries of the firm [Wright, Ennew and Starkey, 1992]. However, these boundaries are not arrived at in a deterministic manner but rather are influenced by firms' different competences and capabilities. These competences and capabilities of firms usually assume a critical role in ascertaining the mode and speed of change [Prahalad and Hamel, 1990]. Hence, the learning systems in some firms may prevent them adapting adequately. The problems may be exacerbated in dynamic markets by the types of external pressures seen in Figure 1, which relate to new legislation, new suppliers, new products, technological change, new competitors, market growth and development, and threats to ownership from the market for corporate control.

In this environment, the development of strategies and structures is part of a constant process of search for a set of assets which fits the firms given competences [Cable, 1977]. The degree of fit may be influenced by changing environmental and technological conditions [Chiplin, 1986], the size of the subsidiary, and the life cycle of product markets [Pashley and Philippatos, 1990]. Often, this search process will involve an element of diversification into related or new products or markets. When acquisition is chosen over organic growth as a means of entry into new or related areas of business, this approach may be replete with problems which are well documented in the merger literature. In addition to the considerable debate surrounding the nature of returns to acquiring firms [Wong, Wright and Thompson, 1991], a major obstacle encountered by acquirers is their ability to integrate the different cultures and management styles of the parent company with those of the newly purchased subsidiary, which may induce harmful resistance to change and prevent potential merger benefits from being fully realised. For example, the way the head office of a bank monitors its branches may differ significantly from the way estate agencies operate and it may not be easy to accommodate all these different requirements within a group structure. In addition, for incentive purposes, it may be necessary to design different remuneration packages to managers and employees operating in different market sectors. This is exemplified in the case of estate agencies, which may dictate not only a more flexible mode of operation but also a more entrepreneurial remuneration package than the traditional banks or building society branches. Similar problems were encountered by a number of major banks in their attempts to integrate securities businesses into traditional banking cultures [Gardener, 1990].

Therefore, organisational change can be understood in part as a process of experimentation with different strategies and different

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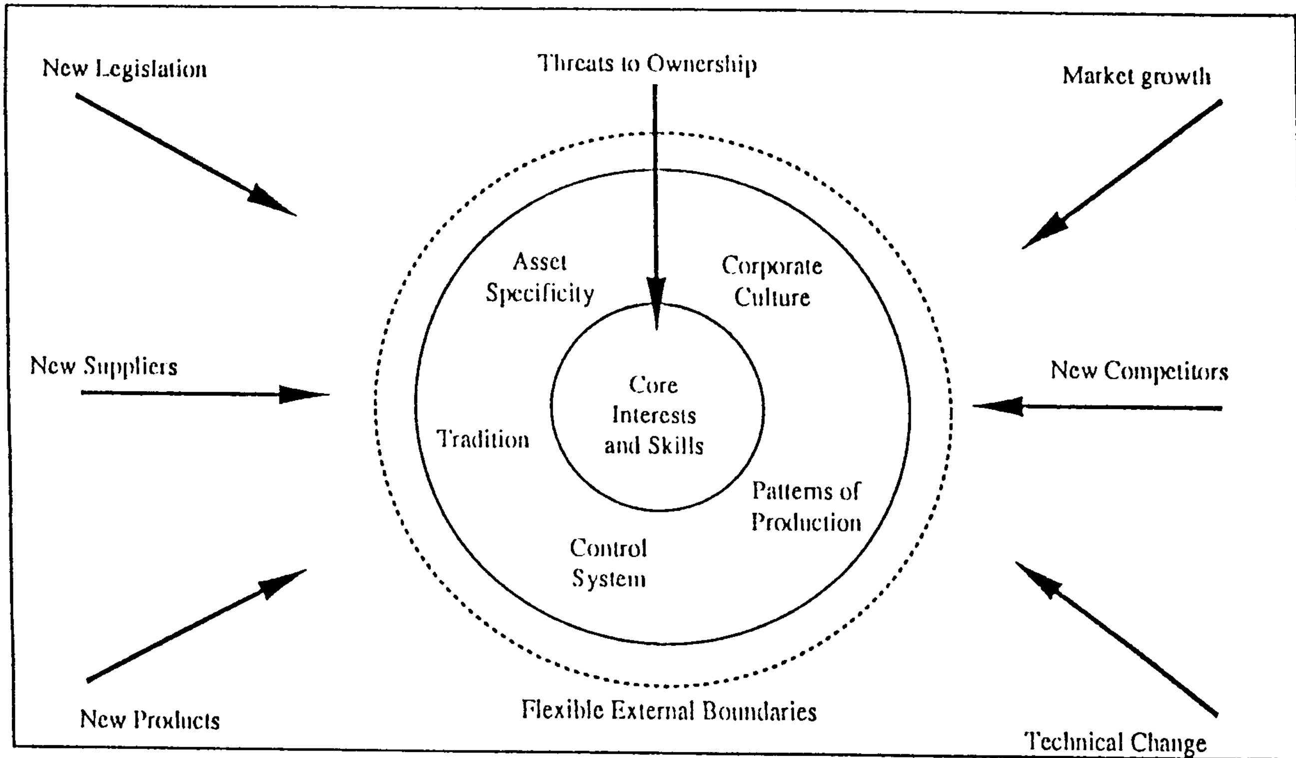
FIGURE 1
PRESSURES ON ORGANISATIONAL BOUNDARIES AND CONTROL SYSTEMS



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management structures. As part of this process, subsidiaries may be acquired which are subsequently found not to fit with the parent firm's overall objectives. Poor fit may mean unsatisfactory performance, but it may also relate to mistakes in acquiring an entity which cannot economically be integrated into the group as a whole. Thus, an activity which was originally compatible is no longer [Harrigan, 1980; Duhaime and Grant, 1984]. It has been suggested that these types of negative synergy were significant in the restructuring of US of investment banking, and to a lesser extent in the context of the UK experience post 'big-bang' [Gardener, 1990].

THE CHARACTERISTICS OF FINANCIAL SERVICES

In the context of the general framework presented in the previous section, it is important to note that there are a number of features of services in general, and financial services in particular, which may have a significant bearing on organisational structures and the pattern of organisational change. The extent to which services and physical goods differ is the subject of considerable debate [Cowell, 1984]. It would be a mistake to assume that services and products are polar extremes; they are not, but there are a number of characteristics which are typically dominant in services and which affect the development of strategies and organisational structures within service businesses. The fundamental difference between services and goods is that services are more or less intangible and goods are more or less tangible [Bateson, 1977, Eiglier and Langeard, 1977]. This intangibility arises because the service is a process rather than an outcome. As a consequence, production and consumption are effectively simultaneous and the service is therefore perishable. Furthermore, services are often thought of as being highly variable in quality because of the high level of labour input. It is important to note that the concept of intangibility has two dimensions to it. The more commonly recognised is the notion that an item lacks physical form – it is impalpable. The second dimension is concerned with mental intangibility, namely, the idea that the service may be difficult to understand. This is of particular significance in the case of financial services, which are widely recognised as highly complex products that are not easily defined and may be difficult to understand [Donnelly *et al.*, 1985].

In addition to these characteristics, there is another feature which can be considered unique to financial services and which affects their management. This is the issue of fiduciary responsibility, which refers to the implicit responsibility financial services organisations have in relation

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to the management of funds and the financial advice they supply to their customers. Although any business has a responsibility to its consumers in terms of the quality, reliability and safety of the products it supplies, this responsibility is perhaps much greater in the case of the financial service organisation [Marsh, 1988]. This may be explained partly by the fact that consumers of such services often find the precise details of the services difficult to comprehend and are therefore placing their trust in the organisation they deal with. Equally important of course is the fact that the 'raw materials' used to produce many financial products are consumer's deposits; thus in producing and selling a loan product, the bank has a responsibility to the person taking a loan, but at the same time, it also has a responsibility to the individuals whose deposits have made that loan possible.

If we consider the impact of these characteristics on organisational structures and organisational change, then a key issue in the context of the transactions cost approach is the high level of asset specificity, which is likely to be a characteristic of service businesses in general and financial service businesses in particular. For many organisations, face-to-face encounters are the primary mechanism for service delivery and the customer's relationship with the personnel providing the service may be stronger than with the organisation itself. As the complexity of the service increases, the greater is the need for trust and confidence in the service provider [Eiglier and Langeard, 1977; Bowen and Schneider, 1988; Gronroos, 1990]. This confidence element is particularly important when the service involves very specific skills (investment or money management, for instance), or where the risks associated with the service may be high (such as managing money). As a consequence, attracting and retaining the appropriate personnel becomes central to the success of the service business, since these personnel will be the key to attracting and retaining profitable business. The skills acquired by these individuals are frequently highly specific to the firm and the markets within which it operates. Firms looking to move into new markets or new market segments will find these skills difficult to create internally and rather easier to gain by acquisition, as was illustrated by the decision taken by building society and insurance companies to move into estate agency by purchasing existing networks in the mid to late 1980s. However, when the skills of individual employees are a key to the success of a business, acquisition is also a risky strategy because of the possibility that specialist personnel will not remain with the acquired firm [Thomas, 1978]. Again, estate agency business provides a clear example of the pitfalls which providers of services may encounter. The difficulties experienced by newly acquired estate agency businesses were partly attributable to

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problems in the housing market, but were also due to the loss of business to new firms established by the sellers.

If we return to the notion of a particular organisational form as a device for minimising transactions costs, a high level of asset specificity will tend to encourage a greater degree of hierarchical governance rather than market governance. This situation is characteristic of many firms operating in the financial service sector. Banks and building societies rely heavily on branch networks and many insurance companies have a high level of dependence on their own tied sales forces. Even in cases where external arrangements for service provision (broker networks, independent agents, etc.) are chosen, these typically involve a form of bilateral governance which requires close links with the ultimate service provider. Sudden changes in the environment in which these businesses operate will typically provoke structural adjustments as organisations search for the most appropriate strategic 'fit'. Given the high level of asset specificity, it seems likely that growth and diversification will require new skills to manage the products. To the extent that these skills are difficult to generate internally, organisations may choose merger or acquisition as an appropriate route to gain access to the specific assets required to operate in these new markets, despite the risks which may be involved. Should these moves prove unsuccessful (for whatever reason), then it is equally likely that divestment may be seen as necessary to restore earlier organisational structures. The financial service sector has experienced just such a period of environmental and strategic change which has provoked a period of extensive organisational restructuring.

THE FINANCIAL SERVICES SECTOR

The Financial Services Act (FSA) was enacted some five years ago and represented a major element of extensive deregulation which radically altered the nature of the UK financial services sector. The changes also involved the Building Societies Act 1986, which broadened the range of activities in which societies could operate, and 'Big Bang', which revolutionised the system of stock exchange dealing. These legislative developments in the system of regulation of financial services continue in a broader context in the form of the EC's Single European market programmes. The effects of legislative change were reinforced on the supply side by developments in information technology and globalisation. On the demand side, an increase in the volume of personal savings and a requirement for increasingly sophisticated products from more financially aware consumers also affected the way in which suppliers of financial services looked at their markets.

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As a consequence, traditional suppliers of financial services found themselves operating in an increasingly competitive environment. Established financial institutions moved into areas from which they had often been precluded and firms not previously offering financial products, such as retailers, began to do so. Many financial institutions took advantage of these opportunities presented by legislative and other changes through a major programme of strategic change involving new product development, diversification, experimentation with new organisational structures, and an increase in mergers and acquisitions, [Ennew, Watkins and Wright, 1990]. For example, a survey conducted in 1987, the year following a number of the important legislative changes, found that although almost two-thirds of financial institutions at this time were focused on narrow market segments, 54 per cent of respondents were planning to become leaders across a wide variety of new markets [Ennew, Watkins and Wright, 1989]. The precise form of strategic change varied across organisations and was dependent to some extent on the nature of existing strategies and the resources available. Hence smaller building societies, which were legally constrained in their diversification, did not plan to diversify as much as larger societies. For those societies which are not restricted, other organisational or financial constraints may operate [Wrigglesworth, 1989]. Mergers provide a rapid means of achieving diversification, with some firms being very willing to be acquired either to provide a viable base for even a limited increased range of services or to make it worthwhile for another type of institution (an insurance company or finance house, for example) to consider a joint venture arrangement.

The problem of managing new acquisitions, as seen earlier, raises the general issue as to whether an activity or product should be provided within the firm itself or through some form of market or joint arrangement with another firm. The latter approach may be effected through such mechanisms as joint ventures, minority shareholdings, franchising, etc. For example, the Building Societies Act 1986 enables societies to offer unsecured loans for the first time. The vast majority of societies choosing to offer unsecured loans are doing so through links either with one of the Scottish clearing banks or the Co-op Bank or (more common) with a Finance Company. These links may provide benefits to both societies and finance houses. They enable smaller societies, in particular, to enter the market, and provide ready access to the necessary expertise. For finance houses, the advantages relate to access to a wider branch network and reduction in vulnerability to losing customers if societies supplied the product on their own.

Indications are that greater attention could have been paid to more flexible links than has actually occurred. These outcomes suggest that

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acquisition may not be the most effective means of gaining and sustaining a market presence and that some early movers may subsequently need to unwind their acquisitions.

At the start of the 1990s, these changes are being reassessed. The industry as a whole has begun to question whether some aspects of the regulatory framework, such as those relating to the FSA, are too cumbersome or still do not go far enough, such as the provisions of the Building Societies Act. Individual financial institutions are also consolidating and revaluating the ways in which they have responded to these developments. As it is becoming increasingly apparent that the scope for diversification in the financial services sector is rapidly reaching its saturation level, denoted by a decline in the rate of movement towards differentiation in a subsequent study of building societies [Edgett and Thwaites, 1990], it is highly likely that divestments could be equally important in this process of revaluation and subsequent exit in the same way as mergers and acquisition activity had been in the initial strategic responses. Indeed, there has already been evidence of significant divestment activity among the banks, many of whom have disposed of businesses which were acquired or developed in the wake of the stock exchange liberalisation [Gardener, 1990].

Besides entry and subsequent exit, a certain amount of divestment activity has been directly related to firms' strategies in the light of the legislative changes recently implemented. For example, the polarisation provisions of the FSA saw institutions opting for independent status of investment intermediaries divesting tied activities. In addition, a number of groups sold insurance broking activities to become tied parts of other groups, as will be seen below. All the above factors suggest that a considerable amount of reassessment of diversification undertaken in the late 1980s may be expected. In the next section the extent of such restructuring through acquisitions and sales of assets is examined.

ACQUISITIONS AND DIVESTMENT

Unlike figures for general acquisition and divestment activities which are easily obtainable, there is no separate publication of such information for the financial services sector. To facilitate the observation of trends in this sector, data presented in the following tables were collated primarily from two sources. The Acquisitions Monthly database was used to identify acquisitions and divestments in the sector and the Centre for Management Buy-out Research (CMBOR) database provided details of buy-outs.

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TABLE 1
INDEPENDENT ACQUISITIONS OF FINANCIAL FIRMS IN THE UK

	No.	% of all Acquisitions of Independent Firms	Value £m	% of all Acquisitions of Independent Firms
1985	67	6.9	553.3	5.6
1986	144	10.9	2,356.22	9.4
1987	190	16.1	4,539.04	26.0
1988	140	10.5	2,577.02	12.6
1989	87	7.1	6,793.5	22.6
1990	74	13.2	2,907.0	19.1

Source: AMDATA

Acquisitions

As seen in Table 1, acquisition activities rose steadily from 1985 to reach a peak in 1987, not only in terms of the number of independent acquisitions of financial firms but also as a proportion of all acquisitions both by volume and value. This finding is not surprising as acquisitions may be employed by financial firms to exploit rapidly the diversification opportunities unlocked by deregulation. However, whether precipitated by market saturation or the realisation that gains of diversification have been over-estimated, a subsequent decline in the activity level is striking as the number of acquisitions is only marginally higher in 1990 compared to 1985. Despite this fall in absolute numbers, the market share in 1990 is nevertheless higher compared to the previous two years, due mainly to the significant decline in the general merger and acquisition activities. Like acquisitions of all independent firms which recorded the highest transaction value in 1989 [Wright, Chiplin and Thompson, 1991], this sector also reached a peak in the same year with a value of £6.8m.

Within the sector, the number of building societies continues to fall sharply as a result of acquisition and merger activity related to the growth strategies of the larger societies, who are frequently developing from a strong base in a particular region, and the willingness of smaller societies to combine in order to compete in the provision of traditional products and the wider range of products that societies are now enabled to provide. Indeed, some 71 building society mergers were completed in the period 1985 to 1990 and the total number of societies fell from 167 in 1985 to 115 in 1990.

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TABLE 2
PARENT-TO-PARENT DIVESTMENTS (SELL-OFFS) IN FINANCIAL SERVICES IN THE UK

	No.	£m
1984} 1985}	47	666.1
1986	20	659.0
1987	23	724.1
1988	18	146.0
1989	32	712.4
1990	47	1,353.7
1991 (Q1)	18	67.5

Source: Acquisitions Monthly.

Divestments and Buy-outs

Besides acquisitions of independent firms by established groups, take-over activity can involve sales from one group to another (divestment) or acquisition by the management who presently run an activity (management buy-out, MBO). MBOs may relate to both independent firms and subsidiaries of larger groups. For the five-year period between 1984 and 1988, the average annual number of financial services divestments to other corporations is approximately twenty (Table 2). Signs of a material increase in these transactions emerged in 1989 and in 1990 itself, 47 divestments with a total value of £1.3m were registered. This upward trend appears to be unchanged as the number of divestments reported in the first quarter of 1991 doubled compared to a similar period in the previous year. However, it is interesting to note the decline in value terms, which may suggest that most of the transactions conducted in this quarter are of a smaller scale. Although it is possible to interpret this increase in sell-offs as efforts undertaken by financial firms to rectify former unsuccessful diversification moves, it is also equally plausible that such restructuring actions portray an ongoing process of organisational experimentation.

Another set of buyers for divested corporate assets are managers and at

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TABLE 3
MANAGEMENT BUY-OUTS IN FINANCIAL SERVICES (1982–1991Q2)

	No.	Prop of All MBOs By No.	Prop of All MBOs By Value
1982	2	1.0	0.6
1983	6	2.8	12.6
1984	11	5.1	15.1
1985	16	6.4	6.5
1986	10	3.3	3.9
1987	15	4.5	8.2
1988	17	4.6	2.6
1989	13	3.5	6.7
1990	24	5.0	12.7
1991Q2	17	7.5	6.6
Total	131	4.3	7.0

Source: CMBOR.

the end of the second quarter of 1991, it is possible to identify a total of 131 management buy-outs in the financial services sector as shown in Table 3 [Wright, Thompson, Chiplin and Robbie, 1991]. Compared to parent-to-parent sell-offs, there are consistently few sales in the form of management buy-outs. When expressed as a proportion of all buy-outs, purchases by managers in this sector are around 4.3 per cent by volume and 7 per cent by value [Chiplin, Wright and Robbie, 1990]. It is also worth noting that 8.3 per cent of all completed buy-outs deals valued at over £25m were originated from this sector.

To place the extent of divestment and buy-out activities of financial firms into perspective, these transactions are also examined as a proportion of independent acquisitions in Table 4. Between 1986 and 1988, it is possible to identify only one sell-off or buy-out for every five acquisitions. However, in 1990, as a result of the sharp increase in divestments observed earlier, there is virtually one sell-off or buy-out to match every acquisition. Hence, both divestments and acquisitions play a vital role in allowing financial firms to redraw the boundaries of the firms to correspond with the competitive and dynamic environment. However, it is also clear from Table 4 that the relative amounts of divestment and buy-out activity in financial services are substantially below levels found in the industrial and commercial sector.

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TABLE 4
DIVESTMENT AND BUY-OUTS AS A PROPORTION OF INDEPENDENT ACQUISITIONS IN FINANCIAL SERVICES

(By Number of Acquisitions/Divestments)

	Financial Services %	Industrial/Commercial %
1986	20.8	92.6
1987	20.0	63.9
1988	25.0	75.0
1989	50.6	116.3
1990	95.9	-

Source: AMDATA/CMBOR/Business Monitor MQ7

Product Areas Involved in Divestments and MBOs

As a means of detecting whether certain activities may be subject to higher disposal propensity, Table 5 provides information relating to the distribution of divestments and buy-outs by main product groupings. Insurance broking and consulting experienced high levels of sell-offs not only to other corporations but also as management buy-outs, where it is likely that the polarization criteria of the Financial Services Act have prompted several transactions in this area. In contrast, the buyers of investment management/fund management businesses consist predominantly of parent firms.

The recent incidence of sell-offs of estate agencies, the evidence of which is shown in Table 5, has attracted considerable attention regarding the strategic shifts of financial firms. Following deregulation, many ventures into the estate agency businesses were conducted on the grounds that contact with home buyers provides an important opportunity for the marketing of other financial products. However, the shortfall of cross-selling of products from forecast, integration problems, depressed market conditions and persistent losses have initiated a conspicuous withdrawal from this area via divestments and closures, most notably that of Prudential, formerly the market leader. Some of the financial firms involved in this estate agency rationalisation exercise include Provident Financial, Royal, Hambros Countrywide, Nationwide-Anglia, Black

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TABLE 5
MAIN PRODUCT GROUPS FOR DIVESTMENTS AND BUY-OUTS (1989–1991Q2)

	Divestments*	Buy-outs
Investment Management/Fund Management	13	2
Insurance Broking/Consulting	11	24
Stockbroking/Securities	9	4
Insurance (Gen)	9	7
Leasing/H.P.	8	3
Estate Agency	7	6
Retail/Merchant Banking	7	3
Financial Services	6	3
Life Assurance	5	1
Credit Card Operator	3	-
Consumer Credit	3	-
Underwriting	3	-
Trust	3	-
Mortgage Finance/Admin	3	4
Other	7	3

*Note: information available only up to Quarter 1 1991.

Horse and Abbey National, but the largest and most prominent retreat was Prudential's complete disposal of 795 agencies.

Multiple Divestment and MBO Activity

Multiple divestors in financial services between 1989 and the second quarter of 1991 are tabulated in Table 6 and it is obvious that such reorganisation activities are carried out not only by financial firms but also non-financial firms as well. The sale of its credit card operations, Debenhams Investment Services and Bell Noble Elliot by the Burton Group, the disposal of two consumer finance houses by Thorn EMI, the divestment of Boots life insurance interests, the sale of Cobbold Roach by Elders IXL and the sell-offs of financial services by both Bromsgrove Industries and Berisford International are all part of a wider corporate restructuring movement by firms to return to their core businesses through the process of de-diversification.

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TABLE 6
MULTIPLE DIVESTORS IN FINANCIAL SERVICES (1989–1991Q2)

	Sell-offs#	Buy-outs	Total
British and Commonwealth	6	2*	8
Berisford International	5	-	5
Burton Group	3	-	3
Hogg Robinson	3	-	3
LIT Holdings	3	1	4
Bromsgrove Ind.	2	2	4
Chase Manhattan	2	-	2
Elders	2	1	3
EFT	2	-	2
Hong Kong and Shanghai Bank	2	-	2
Newman Birts and Partners	2	-	2
Post Office	2	-	2
Prudential Corp.	2	2	4
Standard Chartered	2	-	2
Steel Burrill	2	2	4
York Trust	2	2	4
International City Holdings	1	1	2
Dominion International	-	3	3
Thorn EMI	2	-	2

Information available only up to Quarter 1 1991.
* Prior to receivership.

Acquisition and Divestment Activity

Financial institutions may undertake both divestment and acquisition activity within the same period as they adjust their asset portfolios. Table 7 indicates that a substantial majority of divestors had not made acquisitions in the period. However, a small number of firms were clearly undertaking extensive realignment – both in terms of changes within similar activities (for example, Steel Burrill's acquisitions and divestments in insurance broking and related interests, Hogg Robinson and LIT Holdings) and with respect to reducing or exiting financial services and focusing on industrial and commercial activities (for example, Bromsgrove Industries and to a lesser degree Boots and Thorn EMI). Other financial service firms have made occasional divestments but were active acquirers in the period (for example, Provident Financial exited

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TABLE 7
INTENSITY OF DIVESTMENT AND ACQUISITION ACTIVITY (1989–1991Q1)

	Numbers of Divestments and Buyouts				
No of Acquisitions	1	2	3	4	5+
0	61	9	3	-	-
1	7	1	-	1	1
2	3	-	1	-	1
3	4	-	1	1	-
4	2	-	-	-	-
5+	1	-	1	-	-

Source: AMDATA/CMBOR

from estate agency but made several acquisitions in other financial services; Burns-Anderson sold hire purchase activities and acquired a number of employment, marketing and financial advisory agencies; and Legal and General sold its reinsurance activities but made a number of acquisitions of estate agencies).

Continental European Developments

The points made above in respect of the United Kingdom may also be extended, perhaps even more so, to a European market. Financial services firms have sought to enter continental European markets in anticipation of the Single Market in a variety of ways: greenfield site development, joint ventures and acquisitions of majority or minority share holdings. Cross-border activity in each of the last three increased substantially towards the end of the 1980s (see Table 8).

Each method of entry may pose particular problems – greenfield developments may be slow and require the establishment of an institution's name and joint ventures may be useful for a limited period and involve significant problems of satisfying the interests of the different parties involved [Ennew and Wright, 1990]. Cross-border acquisitions initiated by firms to take advantage of the liberalisation of European financial services are exposed to similar problems of assimilation encountered by domestic diversification, which may be exacerbated by different cultures prevailing in different countries. Hence, like the fate of some domestic ventures, these overseas attempts of expansion by acquisitions may also be followed by a subsequent programme of divestments as part of a readjustment process. This operation is still in its infancy, but it is possible to identify some European divestments. In the case of Guardian Royal Exchange, two of its Italian subsidiaries, acquired in March

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TABLE 8
LARGE CROSS BORDER FINANCIAL SERVICES MERGERS IN THE EC

	1986	1987	1988	1989
Majority Holdings	20	24	51	50
Minority Holdings	11	28	54	50
Joint Ventures	6	7	20	21

Notes: 1. Figures relate to twelve months ending June each year.
2. Financial Services represent banking and insurance.
3. Includes both mergers within the EC involving sellers and acquirers and mergers involving third countries.
Source: EC Annual Report on Competition Policy.

1989, were sold to Instituto Bancario San Paolo di Torino (Italy) in January 1991, after conceding that plans of cutting costs and introducing new management systems have been over-zealous. The sale of Victory Re by Legal and General to the Amsterdam-based Netherlands Reinsurance Group and Prudential's divestment of its Belgian subsidiary, Compagnie d'Assurance de l'Escaut, may represent the firms' strategic plans to concentrate on core businesses.

CONCLUSIONS

This article has highlighted the extensive amount of restructuring occurring in the UK financial services sector undertaken in response to the various environmental changes. The concept of asset specificity, pioneered in transaction cost economics, is employed here to examine and explain some of the developments found in this sector.

It is proposed that as asset specificity is likely to be high due to the distinctive characteristics of financial services, firms may be more inclined to use acquisitions for growth or diversification purposes. Subsequent evaluation of the effectiveness of such a strategy, which may have been adopted under conditions of very rapid changes and amidst a high level of uncertainty, may lead to the use of divestments to exit from sectors into which they have recently diversified. Such reversals of earlier moves into financial services are also carried out by non-financial firms such as retailer groups. As supported by the empirical evidence, where the spate of acquisition activity is followed by a recent increase in divestment activity, this pattern of activity suggests that a certain measure of organisational experimentation is taking place.

Although these asset sales mirror a similar phenomenon among indus-

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trial and commercial firms which is more firmly established, levels of divestment and buy-outs in financial services are lower compared to other industrial sectors. The pattern of purchases demonstrates that whilst some firms are withdrawing, other financial institutions are acquiring their divested assets. Within the European context, there are also some emerging signs of similar organisational experimentation as firms reposition themselves.

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