The Development of Capital Markets and Strategic Finance in Austria and the New Europe

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The nation of Austria is in a unique position to fully capitalize on the changing political and economic environment that is taking place throughout Europe. Since 1989, the fall of communism and the Iron Curtain has acted as a conduit of commercial development, resulting in increased trade of goods and services as well as streamlined financial markets. Austria has historically strong ties and geographic proximity to the developing economies of Eastern Europe and is a small but important member of the European Union (EU) and European Monetary Union (EMU). With these key advantages, Austria is positioned to play a central role in the further development of European capital markets and strategic finance.

As a member of the EU, Austria is part of an historic socioeconomic change. The European Union is the political and economic culmination of centuries of interdependence and international relations. Currently composed of 15 sovereign governments, though several notable neighbors are absent, the EU unites many important and influential societies and economies. The most recent development, one that many believe to be the most important, is the adoption of Europe's first common currency, the euro. This action joins together diverse countries and their economic systems. Consequently, a new and massive market has begun to emerge; and when there is opportunity and business there is strategic finance. The common currency and market in Europe is, and will continue to be, highlighted by the development of a complete and diversified capital market. The implications from this are global in scope and important to all who seek to benefit from its possibilities.

In what follows, I begin by presenting an overview of the EU and EMU. I then examine Austria's economic and political position in Europe, and then analyze the progression and
growth of capital markets. I next discuss the corporate restructuring environment in Austria and Europe. Lastly, I conclude with some thoughts on Austria’s role in the integration of developing markets into the rest of Europe and the future of European strategic finance.

**European Monetary Union and the Euro**

The convergence of national representatives in Maastricht, Netherlands, in 1992 resulted in the landmark treaty of the same name. This pact created and defined the EMU, which set the stage for the euro, the single currency of those member nations. They are Germany, France, Italy, Spain, the Netherlands, Belgium, Finland, Portugal, Ireland, Luxembourg, and Austria. Notable holdouts include the United Kingdom and Switzerland, both important financial centers. As of April 2000, the Prime Minister of Denmark has announced that he will push forward by several months that country’s planned national referendum to decide on joining the EMU, a likely indication that his government is eager to adopt the euro. A number of fiscal requirements for each member nation are outlined in the document, all seeking to make converging economies centrally manageable.

The European Central Bank (ECB) is based in Frankfurt and manages the monetary policy of the euro. The ECB is composed of six executive board members and eleven national central bank governors, one from each EMU member nation. The ECB sets interest rates and attends to financial matters important to the entire economic area. With the EMU and its central bank, the nations involved believe that integration will not only foster commercial development and opportunity, but will also increase stability, security, and interdependence in the region. Surely it would not make sense for two or more members to engage in conflict if they make use of the same currency, are governed by a common central bank, and have similar market interests. Another important aspect of the European Union is the collective bargaining power that comes with unification of interests. The likelihood of additions to the EU as well as additional measures of government centralization in Brussels has led to speculation of a common foreign policy. It is even possible that the European Union could one day essentially become a United States of Europe.

As one can imagine, governance and regulation of the euro has already proven to be a challenge. Introduced into institutional transactions and settlements in 1999 and with plans for printing and circulation in 2002, the euro has already undergone a significant decline against the dollar. One of the biggest challenges of setting appropriate interest rates for the euro is the necessity of applying monetary policies to various and diverse economies, from Austria to Portugal. Consequently, the ECB uses aggregate figures derived from the entire Eurozone when making decisions, as opposed to evaluating economic data from several different areas. (Barber, “A Banker Skilled in Diplomacy,” p. 8)

In early 2000 the euro dropped to and then fell below parity with the dollar. Eurozone inflation increased 1.7 percent during 1999, and unemployment fell to 9.6 percent in December 1999, down from 10.5 percent during the previous year. (“Euro-Zone Inflation Continues Uptrend,” p. A14) The corresponding downward pressure on the euro and the need to provide some support against other currencies have resulted in real tests of the ECB to manage interest rates. In late January 2000 the ECB raised interest rates for the second time since its inception to a main refinancing rate of 3.5 percent, up from the initial rate of 3.0 percent. Central bankers hope this rise will head off increased inflation fears, as strong growth is predicted to continue well into 2000 to as much as 3.5 percent during the year. (Thornton, p. 15) The Maastricht Treaty outlines goals to combat inflation, remarkably similar to the goals of the United States Federal Reserve System.

Overall, the International Monetary Fund projects European Union GDP growth in 2000 to be 2.7 percent, inflation to be 1.5 percent, and the unemployment rate to be 8.8 percent. (“IMF Euro Zone Economic Forecasts”) In essence, the euro and the economic union in continental Europe should continue to have strong influence over virtually all business activities throughout the area. All of these reforms lead to a new beginning for European commerce; thus, as companies scramble to take full advantage of better financial efficiency, the stage is set...
for revamped and streamlined capital markets, greater consolidation across industries, and expanded strategic financial activity. At the center of this economic renaissance is the small but vibrant nation of Austria. It is well positioned to play an important role in integrating the emerging eastern European markets into the developed market economies of the west, and is in place to take part in strategic financial issues overspreading the continent.

Austria and the European Community

The foremost ramification of monetary union in Europe is the increase of fluidity in markets. Consequently, there are a variety of benefits associated with the single European market, one of which is the elimination of non-tariff barriers. (Teufelsbaur) Multinational corporations no longer have to hedge numerous foreign currencies, thus eliminating fees associated with those arrangements. The euro also reduces transaction costs of business ventures, and therefore facilitates a heightened flow of goods. Increased foreign competition is also now present, forcing companies to cut costs and become more efficient.

This puts Austria in a unique situation to take advantage of the increasing capital flow. Surrounding nations, including Slovenia, the Czech Republic, and Hungary, are promising emerging markets that could be the target of foreign direct investment by Austrian businesses and important trading partners with the rest of Europe. As part of a fully developed economy with excellent infrastructure and integration with the EU, Austrian companies can act as a bridge between these developing nations and investors by providing necessary capital, commercial skills, and access to important business relationships.

Austria and its role in the expansion of the EU are of particular importance. Only half a century ago it was under the control of Nazi Germany and was a struggling economy, but today Austria is one of the most prosperous nations in the world. A center of technology and service industries, Austria plays a key role as a primary link between eastern and western Europe. According to Mario Rehulka, joint Chief Executive Officer of Austrian Airlines, as of 1999 Austria represents 30 percent of foreign direct investment in eastern and central Europe. (Rehulka)

This significant influence on its neighbors has a tremendous impact on the Austrian economy, as well as on those of its trading partners. While the EU-15 nations remain the most important trading block for Austria, comprising 70 percent of total imports and 64 percent of total exports in 1998, eastern European countries are playing a far greater role than in previous years. ("Foreign Trade") In fact, imports from EU states grew 50 percent and exports 62 percent between 1993 and 1998; yet imports from eastern European nations increased 130 percent and exports rose 117 percent over the same period. Exports to eastern Europe also comprised 17 percent of total exports in 1998, up from less than 13 percent in 1993. As the emerging markets to the east continue to grow and become more important to the Austrian economy, the country should expect more benefits from increased trade levels.

Although rather small and populated by only eight million people, Austria has experienced a prolonged period of growth and innovation over the past decade. Real gross domestic product is expected to grow 2.5 percent in 2000, and inflation is predicted to remain low at 0.9 percent, which is well below the 2.7 percent inflation expected in the European Union as a whole. ("Euro Zone," p. 5) Also, Austria has one of the lowest unemployment rates in the world, which is expected to fall to 4.2 percent in 2000. ("IMF Euro Zone Economic Forecasts") All of this has contributed to Austria’s strong foreign currency and long-term debt rating of AAA, as assigned by Standard & Poor’s. ("Sovereign Ratings") Sovereign fiscal strength is extremely important in fostering a competitive marketplace, and Austria is a leader among Euro-zone nations.

Clearly, Austria appears to be well situated to capitalize fully on the potential opportunities created by the EMU and the European Union. However, recent developments in Austrian politics have clouded future expectations. Elections in January 2000 resulted in a new government that brought to power the far-right Freedom Party led by Joerg Haider. The isolationist feelings and opposition to the EU by his supporters raise questions about Austria’s future in the new
Europe, and have led the political body of the EU to condemn the new government. The ECB has even identified diplomatic problems with Austria as a reason for weakness of the euro. (Barber, "Politics Obscure Economic Gains," p. 2) Nevertheless, the financial ramifications of political strife have yet to fully materialize, and overall Austrian economic performance continues to be encouraging.

**Development of Equity and Debt Markets**

The increased liquidity resulting from the onset of the euro has provided a better way for companies to finance growth and operations: equity capital. In the United States, firms have been using equity as an important source of capital for decades. While the European market for stocks has also been good, based predominantly out of London, Paris, and Frankfurt, almost all of the numerous exchanges located throughout the continent, including Vienna, are now denominated not in separate currencies but in euros.

Most equity investors in America and in Europe are institutional money managers: i.e. those in control of mutual funds, pension funds, and insurance companies. Although institutional investors have long been major players in moving equities in the United States, the European common market is allowing money managers to more efficiently compare stocks and better evaluate performance. In essence, companies and their stocks can no longer hide behind their national currencies.

Accordingly, both individual and institutional demand for European equities is greatly expanding, creating high demand for new stocks and equity-related issues. European trading volumes grew 42 percent in 1999, helping the FT/S&P World Index increase 24.2 percent. In comparison, New York Stock Exchange total volume jumped roughly 27 percent in 1998. ("Historical Factbook," p. 91) New European international equity issues rose 66 percent to $82.7 billion, reflecting high investor demand for stocks. (Brown, p. 6)

The Vienna Stock Exchange, or Wiener Börse, is completely electronic and as of November 1999 became fully integrated with the Deutsche Börse in Frankfurt through the Xetra trading system. This allows market participants access to all stocks on both exchanges and greatly increases overall liquidity. Also, this cooperation will lead to the creation of a joint stock exchange based in Vienna that will be used for the purpose of trading central and eastern European equities in order to increase efficiency, transparency, and liquidity of dealing emerging market securities. This leadership position will help Austrian securities firms make markets for these stocks, and will create a pathway for central and eastern economies to gain access to developed capital markets. Lastly, the Austrian cash market and the futures and options market merged in 1998 to strengthen Vienna's growing position as a financial center. Total trading volume on the cash market increased 35.9 percent in 1998. (Annual Report of Wiener Börse AG, p. 1)

Although the Wiener Börse has grown significantly over the past ten years, the London Stock Exchange continues to be the primary location for listed equities in Europe. The Deutsche Börse in Frankfurt is a close second in terms of volume and number of member companies, although it is still behind Paris in market capitalization. In time, it is likely that more EU exchanges will be brought together, facilitating trades and tremendously enlarging liquidity. As of March 2000, the Paris Bourse, Amsterdam Exchanges, and Brussels Exchanges have discussed a merger that would create the second largest equity exchange in Europe, with a combined market capitalization of 2.4 trillion. (Ascarelli and Carreyrou, p. A23) However, exchange integration in Europe could face difficulties, because there are numerous clearinghouses that still make dealing stocks many times more expensive than in the United States, where settlement organizations are more streamlined.

Surely, if the United Kingdom were to join the European Monetary Union, as many speculate will eventually happen, a convergence of London and continental exchanges will create a market to rival those in New York and Tokyo. Transaction costs will decrease and access to international orders will improve. ("The European Alliance") Importantly, issuers will have an improved gateway to a vast pool of European capital and a large array of potential shareholders, partially a result of continued
industry privatization in central and eastern Europe. (Fairlamb, "EMU: A Catalyst for Change...", p. 2) With the local Wiener Börse and complete electronic access to pan-European markets, Austrian businesses will be able to take further advantage of geographic proximity to and existing ties with eastern industries, as well as established western trading partners and customers.

While equity issuance is quickly gaining ground, the primary method of financing operations in Austria, as well as throughout Europe, has long been bank loans. This is due largely to the traditional lack of liquid equity markets, as well as to social and cultural differences associated with being public corporations. Europeans have tended to be more risk averse in general business decisions than Americans; and since equity is the most expensive form of capital, most companies have usually sought less risky traditional credit. In turn, large domestic and regional banks have provided ample capital, evident in the sizable balance sheets of large European depository institutions. Many of the world's largest banks in terms of assets are European, including Deutsche Bank, UBS, Credit Suisse, ABN Amro, HSBC, and BNP Paribas. In fact, bank loans total 182 percent of GDP in Europe, compared to 69 percent in America. (Luce, p. 1) This indicates a higher overall degree of operating leverage and an aversion to more risky sources of capital, including private and public equity. However, the onset of monetary union and the euro have already fostered companies' use of equity capital, in light of greater liquidity and investor access to broader markets.

Initial public offerings (IPOs) of European companies are drastically increasing, as management teams flock to new capital from investors. Specifically, as of April 2000, €234.3 million in stock has been issued and listed on the Wiener Börse. ("New Listings 2000") Overall, IPOs in Europe amounted to $55 billion during 1999, three times the level of the previous year. Even venture capital investments are growing, as $20 billion was poured into European companies and start-ups in the same year. (Edmonson and Fairlamb, p. 84) This is particularly interesting, as this represents one of the most risky forms of financial resources available, given the high rate of start-up failures and the traditional European aversion to enterprise collapse.

Austrian industrial and technology companies are flocking to this form of capital and satisfying investor demand for a part of this thriving market. For example, when Mayr-Melnhof Karton AG, a Vienna-based carton manufacturing company with 1998 sales of €905 million, went public in 1994, the company was seeking capital to grow and better compete with industry rivals. MM Karton is listed on the Wiener Börse and participates in an American Depository Receipt (ADR) program in the United States. As ADRs are used to increase liquidity for international equities by trading the receipts of a foreign stock deposited in a bank, it is possible that as European markets continue to evolve and integrate globally, their use will decline. In this case, the IPO increased share capital by 30 percent, and the firm has since undertaken acquisitions utilizing the equity proceeds. Morgan Stanley Dean Witter, the 1999 leading bookrunner for European equity issues, took the company public and was chosen through a competitive process. (Gröller)

American securities firms, far more than European investment banks, have taken Europe and its new market by storm. With all of the new business created from market integration, companies have been flocking to underwriters with broad market range and global research and distribution capabilities. While European banks, such as Lazard Frères and UBS/Warburg Dillon Reed, are relatively strong players, American banks have the most pronounced access and experience in the U.S. capital markets to distribute shares to investors around the globe. Consequently, American banks have been building their presence in Europe, particularly in London and Frankfurt, over the past decade to reach a growing number of clients in a booming area of finance. Specifically, the growing European technology sector has been under American influence, and the major U.S. banks have had far more experience with underwriting technology issues. Also, many institutional money managers in the United States are shifting strategies to include more European shares, and American dealers are providing the necessary services and coverage to them.
Essentially, U.S. banks have deep roots in the American market, where European banks are far less involved. Since the European market is now starting to expand in size and scope, those American banks are leveraging their experience across the Atlantic.

For the first three quarters of 1999, Morgan Stanley Dean Witter led $9.3 billion in European equity issues, ranking first among stock underwriters. Goldman Sachs, the perennial leader in America, was second with $5.9 billion; Merrill Lynch rounded out the top three with $4.3 billion, respectively. UBS/Warburg Dillon Reed and Deutsche Bank were the only European houses ranked in the top five, with $4.3 billion and $4.1 billion. Although the latter European firms are contenders, large American banks will be hard to beat as capital market expansion carries on. (Reed, p. 71)

While the proximity of regional financial centers gives these large firms access to Austrian business, their lack of presence in Vienna creates an opportunity for small, local and regional underwriters and banks to create and maintain relationships with Austrian companies, as well as with nearby emerging markets.

Underwriters should be able to do much more business on the continent; Donaldson, Lufkin, & Jenrette calculates that the European market has the potential to issue $4.6 trillion in additional equities. (Reed, p. 72) This assumption is based on the fact that the current aggregate value of equity markets in European countries in comparison to gross domestic product levels is considerably below the comparable rate in the United States. As a whole, the U.S. equity market represents 152 percent of GDP, as opposed to 99 percent in Europe. (Luce, p. 1)

As the importance of equity in Austrian and European corporate finance has grown, so have the corresponding debt capital markets. Companies in search of money are tapping into investor demand for securities with steady income streams. With the high potential for industry growth, European firms are borrowing more than before, and traditional bank loans are not always servicing these needs. Also, comparatively low interest rates in the EU help keep interest payments manageable. New issues of corporate bonds in 1999 denominated in euros were €425 billion, and overall issues grew 60 percent from 1998 to a total of €756 billion. (Ostrovsky, p. 6)

Governments are also cashing in on the market for fixed-income instruments. In January 2000 Austria issued €3 billion of seven-year benchmarks, following Portugal’s float of €2.5 billion of five-year notes. The deals were much larger than government borrowing in the capital markets had previously been; they were both syndicated issues instead of the significantly smaller traditional bond auction where debt was denominated in local currency instead of the euro. (Wendlandt, p. 35) This is important because syndicated issues are underwritten by a group of banks; before the euro, this activity would be far more difficult to transact in the necessary variety of currencies. Therefore, along with its peers, Austria will be able to more easily raise capital on a national level. This should spill over to developing industries in the country as well as to trading partners to the east, facilitating growth in both the best situated Austrian sectors as well as in those facing stronger competition from neighboring economies.

The market for high-yield debt, commonly known as junk bonds, is also gaining strength in Europe. As of October 1999, the European high-yield market had roughly $40 billion outstanding, which pales in comparison to $600 billion in the United States. (Luce, p.1) However, three out of every four credit ratings issued by Standard & Poors in Europe during 1999 were for companies selling high-yield debt, and the junk bond market in Europe could reach $280 billion by the end of 2004. Consequently, the leveraged buyout universe is continuing to grow on the continent, riding the wave of demand for high-yield capital. Takeover firms performing leveraged buyouts issued $30 billion of junk bonds during 1999. (Fairlamb, “Europe Races into a World of Junk,” p. 134)

All newly formed capital in Austria is a benefit not only to itself and local corporations, but also to the entire European and global market. Free-flowing wealth will help industry pioneers and their ideas come to fruition, having beneficial macroeconomic and sociopolitical ramifications. While expanding capital markets and monetary union are key to Austria’s con-
continued economic expansion, these represent only a portion of the development of the entire financial system.

**Mergers, Acquisitions, and Corporate Restructuring**

Europe as a whole has witnessed a virtual explosion of mergers and acquisitions (M&A) activity since the announcement and implementation of the EMU. In fact, for the first time in seven years European M&A activity in the third quarter of 1999 was higher than that of the United States, with $377 billion and $322 billion, respectively. (Boland, p. 25) According to Thompson Financial Securities Data, 1999 European-announced M&A totaled $1.218 trillion on 12,225 deals, compared to 10,831 announced deals in the U.S., valued at $1.756 trillion. ("The Players: Why All Eyes...") Clearly, recent global M&A activity has been extremely high, but most importantly the trend in Europe has been nothing short of amazing. The euro and the EMU are certainly the primary drivers behind this activity; liberalization of markets has increased foreign competition and has forced companies to consolidate and acquire others in order to gain access to new markets.

As companies and industries continue to combine, cross-border activity has skyrocketed as well. Major deals have brought once fierce competitors together, as exemplified by the recently announced merger of Vodafone AirTouch PLC of London and Germany's Mannesmann AG, a deal valued at an astounding $179.66 billion. (Boston, Naik, and Raghavan) This combination creates the world's largest wireless telecommunications provider, with total access to 42.3 million customers throughout Europe and the United States. This combination is especially important to Austrian customers, as Mannesmann owns 75 percent of the local wireless carrier Tele.ring. The merger illustrates how Austrian consumers and businesses can gain access to goods and services they would otherwise be without through the integration of markets, in part created through monetary union. Smaller local firms such as Tele.ring can now more easily tap the financial and strategic resources of larger companies and in turn benefit both shareholders and customers.

While the telecommunications and technology industry is booming, the changing financial-institutions sector is of great importance. By their nature, major and regional banks throughout Europe have played a considerable role in the economic development of the region. As mentioned previously, bank loans have long been the primary source of capital for companies on the continent, and Austrian firms are no exception. Consequently, major European bank mergers have reshaped the entire industry. During 1999 and into 2000, a number of major deals involving banks have occurred. The French bank Paribas attempted a $37 billion hostile takeover of BNP while it was already engaged in an $18.2 billion merger with Société Générale. Also, National Westminster Bank PLC of London accepted a $33.79 billion takeover bid by Royal Bank of Scotland PLC, after defending itself against a similar bid by Bank of Scotland PLC.

Although there are approximately 1,000 banks in Austria, Bank Austria currently commands 25 percent share of the corporate and retail banking market in the country, and has €134 billion in assets. (Portanger and Rhoads, p. A25) This is important because of the announced merger of Germany's Dresdner and Deutsche Banks, valued at €33 billion. Although the intended merger fell through weeks after being declared, the combined institution would have had assets totaling €1.2 trillion, by far the largest in Europe and second in the world. In order to compete, HypoVereinsbank, the second largest bank in Germany, has made an agreement with Bank Austria, that nation's largest, to take stakes in each other and form an alliance that would create the largest retail bank in central Europe. Through the integration of capital markets, the euro has enabled deals like this one to happen more easily and fluidly, and this wave of M&A activity should continue as the EMU further develops.

Nonetheless, the Austrian banking industry is not completely dominated by one institution. Erste Bank is the second largest bank in Austria, and as of January 2000 is in negotiations to acquire 52 percent of Ceska Sporitelna, the second largest bank in the Czech Republic, in order to gain business outside of the domestic market. If Erste Bank is successful, it will
gain Ceska's $11.66 billion in assets, adding to the $58.5 billion already under its control. Regardless of what happens, the evidence is clear — financial institutions, as well as all industries, are going to continue to consolidate in order to stay competitive and gain advantages over rivals.

The expansion of M&A activity in Austria and throughout Europe is not attributable solely to the euro and its related effects on the market. European executives are now focusing on increasing shareholder value and are consequently moving to increase earnings per share and to seek out accretive deals out of pressure to improve returns. These deals are now often financed through equity and high-yield debt and not simply by cash flow or bank borrowings, and hostile takeovers are now fairly common. These activities are hallmarks of American corporate finance. Deregulation at national levels also helps firms to build greater regional presence, and as competition increases across all industries, so too will the level of consolidation. Overall, the integration and development of capital markets are creating an environment conducive to strategic mergers and corporate restructuring that are likely to continue with the strong pace of economic expansion, both in the EU and in developing Eastern European nations.

**Conclusion**

The global economy has undergone significant and widespread changes over the past decade. Accordingly, the international financial markets have witnessed a dramatic transformation, and nowhere is this more evident than in Europe's creation of a single monetary union and currency. Whereas it may have once been impossible for an Austrian firm to own a majority stake in a Czech company, only to have them both acquired by a French competitor, it is now a distinct reality.

Capital provides the fuel for the market and is the essential engine of today's economy. Only a short time ago banks were the only viable source of funds in Europe, and hostile takeovers were merely an American phenomenon. Now, more fluid and larger capital markets are playing a far more important role in the European economic system than before. Austria, a small but integral part of the European Union, is poised to take full advantage of this opportunity. As a bridge between the industrialized west and developing east, it could not be better positioned.

As Europe continues to come together, both economically and politically, Austria and its thriving economy can reap the benefits. Austrian, as well as all European, firms can now tap essential equity and debt markets for capital used to grow, expand, and become more efficient. Although it plays a comparatively minor role in the European Union, Austria is at a crossroads where financial and economic flows can reshape not only local and regional business and industry, but also help integrate eastern Europe into the global marketplace.
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