HEADING HOME: A CASE STUDY OF HANDELSBANKEN’S NORDIC MARKET EXITS

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Abstract

Recent trends and changes in the banking market have transformed the competitive landscape and forced banks to rethink their internationalization strategies. One of these banks is Handelsbanken, one of Sweden’s largest banks, which announced its divestment of its Danish and Finnish operations in October 2021. Through a case study analysis, this thesis investigates why Handelsbanken chose to divest these two units, as well as how this decision can inform the debate on the optimal geographical scope of European banks. This thesis contributes to existing literature on firm divestment strategies, determinants of bank internationalization, foreign bank performance and recent trends affecting the geographical scope of banking. On a firm-specific level, we find that the divestments served as an important constituent in a strategic refocusing process to concentrate the organization. Our findings also show that Handelsbanken’s divestments were motivated by external factors, such as increased regulatory burden, which diminished scale economics between geographies. This suggests that the geographical scope of a European bank is dependent on its ability to achieve critical mass in each market it operates within.

Keywords: Banks, regionalization, divestments, consolidation
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Contents

1. Introduction

In the 1990s, markets experienced a surge in financial globalization. Factors including deregulation, banking crises and reductions in foreign entry restrictions were the major catalysts in this transformation, where many banks increased their international presence through foreign market entry (De Nicoló et al., 2003). Similar to peers, Svenska Handelsbanken AB (“Handelsbanken”, “the Bank”, or “SHB”), one of the four largest banks in Sweden, followed suit and opened branches in the neighboring Nordic[1] countries. At the same time, the Bank opened a branch network in the United Kingdom, whilst other Nordic banks were exploring foreign entry opportunities in Eastern Europe (Bhide, Campbell and Stack, 2015). For Handelsbanken, this pattern of increased international presence remained throughout the early 2000s. By the end of 2019, Handelsbanken operated as a Nordic universal bank with 800 branches, divided into six home markets organized in 14 regional banks and an international branch network in 20 countries (Handelsbanken, 2020a).

However, following the appointment of the new Chief Executive Officer Carina Åkerström in 2019, the Bank announced its plans to concentrate the Bank. As a part of this strategic transformation, Handelsbanken changed its prior expansion strategy; from being a Nordic universal bank with an international presence, the Bank was to become more focused and concentrate on two core segments, savings and financing. The plan also set forth to reduce its wide branch network in Sweden by half, as well as concentrate its international branch network significantly by closing branches in the Baltics, Poland as well as many global representative offices. On October 19th, 2021, Handelsbanken also announced that they were going to cease its operations in two of its neighboring countries, Denmark and Finland.

Recent trends in the banking market have transformed the competitive landscape and forced banks to rethink their internationalization strategies. Banks are facing challenges connected to more stringent regulation following the global financial crisis, including

[1] “Nordic” is hereinafter meant to represent Sweden, Norway, Denmark, and Finland. Iceland is thus excluded from our discussion.

capital requirements, liquidity requirements, resolution buffers, GDPR, MiFID I and II, and anti-money laundering directives (e.g., Giannetti and Laeven, 2012). Concurrently, digitalization is reshaping the competitive landscape and forces traditional "legacy banks" to compete with disruptors with niche offerings. In essence, these trends have forced many banks to question the future relevance of their business models and require these entities to increase investments in both compliance functions and digitalization projects (Abbott, 2022).

Despite evidence of financial deglobalization and the impact of regulation and technology on the geographical scope of banking remaining modest (e.g., Cerutti and Zhou, 2017; Degryse and Ongena, 2004), there are indications of this trend being more prominent among European banks (Mulder and Westerhuis, 2015). For instance, ringfencing regulation post the financial crisis forced the United Kingdom's biggest lenders Barclays and HSBC to refocus on their domestic operations. Regional consolidation has also occurred among other European retail banks in the latest years, including BNP Paribas and BBVA who retreated from the United States after struggling to compete with big domestic lenders (Franklin, 2022). This thesis aims to contribute to existing literature on the topic by conducting a case study of Handelsbanken's divestments of their Danish and Finnish operations. More specifically, the case study will contribute with empirical insights from one of Sweden's largest banks, supported by interviews with its senior management, investor relations as well as independent equity research analysts. The thesis aims to answer the following research questions:

(1) *Why did Handelsbanken choose to divest their Danish and Finnish operations?*

(2) *How can the Handelsbanken case inform the debate about the optimal geographical scope of European banks?*

Our study reveals that Handelsbanken's decision to divest these two units was both a result of firm-specific aspects as well as external factors. On the one hand, Handelsbanken was amid a strategic refocusing on their core markets and core operations, in which the divestments served as an important constituent to concentrate the organization. Factors such as Handelsbanken's need for further investments in IT and digitalization, together with the Bank having become less cost-efficient and profitable in the past years, called for a change. On the other hand, the decision was impacted by external factors including an increased regulatory burden, which increased the Bank's overhead costs in each international market and forced them to achieve a certain scale to be profitable. Furthermore, local market conditions in Denmark and Finland may have a negative impact on Handelsbanken's operations as a foreign bank. These findings constitute important information for the debate on the optimal geographical scope of banking since it indicates that the layering of supranational and domestic legislation has been a large driver in diminished cross-border synergies. Given that this increased regulation similarly impacts European banks, our findings in the case of Handelsbanken are likely applicable to other European banks as well.

1.1. Purpose

The purpose of this thesis is twofold. First, the thesis aims to examine why Handelsbanken chose to divest their Danish and Finnish operations and explore how this case can inform the debate on the optimal geographical scope of banking. Second, the thesis will serve as a base for material that can be used for teaching purposes for the Department of Finance at the Stockholm School of Economics.

1.2. Contribution

This thesis aims to contribute with empirical insights on a traditional commercial bank divesting two of its international markets. Our initial literature review reveals that evidence of financial deglobalization and consolidation in the banking market remains patchy and limited in scope, although there are indications from both academia and industry that this may be a more prominent behavior among European banks. Research on this topic in the case of Nordic banks nonetheless remains scarce. As a result, this thesis will contribute to existing literature with insights from a real-world example of a Nordic bank divesting two of its international markets. The thesis will further discuss whether the determinants for Handelsbanken's divestments can be informative to the debate on the optimal geographical scope of banking.

2. Literature Review

2.1. Determinants of Banks' Cross-Border Activities

Banking crises, deregulation, and reductions of foreign entry restrictions were the major catalysts in the 1990s surge in financial globalization, with foreign entry in emerging markets including Eastern Europe and Latin America being the most intense. At this time, world foreign-controlled assets almost doubled from around five trillion dollars in 1995 to nine trillion dollars in 2000. The incentive for financial firms to expand internationally has shown to be dependent on the regulatory environment of the host country, as well as the perceived profit opportunities relative to those available in the domestic market (De Nicoló et al., 2003). Adding to this, Mulder and Westerhuis (2015), found that bank internationalization seems to differ between jurisdictions. More specifically, during the period 1980-2007, European banks continued to internationalize whereas US and Japanese banks exhibited the opposite pattern. The study suggests that this can be explained by factors such as the size of the home country and its level of economic and financial development. However, Mulder and Westerhuis (2015) also found that the determinants of bank internationalization differ in importance over time and that the changing regulatory environment is of significance.

Moreover, Cerutti and Zhou (2017) found that the establishment of direct cross-border and local affiliate connections has a strong positive correlation with the geographical distance between countries, as well as the trade relationship between countries, colonial ties, size of the borrower country and a common legal system. Additionally, Canals (1997) found that the commercial banking industry has a strong national component, both from the viewpoint of the banks themselves and the customers. This is partially due to the competitive dynamic and resources associated with commercial banking operations, where foreign banks need to establish a certain size of their branch network to be profitable (Canals, 1997).

2.1.1. Implications of the Basel Accords on the Geographical Scope of Banking

The Basel Committee, founded in 1974, is the foundation of capital requirements for banks. This committee sets standards for banks' capital structure in the form of minimum capital requirements and other risk management practices. These recommendations are implemented into supranational law, such as European Union directives, as well as domestic laws, including the Swedish banking law (Bank for International Settlements, 2021). The first Basel Accord was issued in 1988 and stipulated that banks should keep a minimum level of capital to absorb losses. However, revisions to this framework were made in the form of Basel II (2004) and III (2010). The latter accords mainly calibrated the definition of capital into various categories depending on its quality to absorb losses and allowed banks to use internal models to calculate their risk-weighted assets (Hakenes and Schnabel, 2011). In conclusion, these regulations have tightened the leverage of banks and, ceteris paribus, diminished the shareholders' return on equity ("ROE").

The Fundamentals of the Basel Accords

Basel I required a total capital adequacy ratio ("CAR") of 8 percent of total risk-weighted assets ("RWA"). The RWA, together with CAR, determined the amount of capital the bank needed to hold. Dependent on its risk, asset types were categorized into four categories, spanning from 0 to 100 percent of their nominal value. Basel I, in a simple numerical example, would require a bank with three assets, a government bond, mortgage, and corporate bond, with a nominal of 100 each, to hold zero, 50, and 100, respectively in risk-weight. This would lead to a total RWA base of 150 and required capital of 12. The total capital-to-assets ratio would be 4 percent.

Basel II (2004) and Basel III (2010) came with several amendments to Basel I, dividing capital into two categories: Tier 1 capital, which comprises of common equity or undisclosed reserves, and Tier 2 capital, which includes hybrid instruments and subordinated debt.

Previous research has discussed whether and to what extent the Basel Frameworks impact banks' cross-border activities. Liebig et al. (2007) suggested that Basel II has a neutral impact on banks' cross-border lending activities since banks were already employing credit risk models at the time of implementation. Thus, at the time that Basel II would be in full effect, the impact on banks' loans to other markets would only be negligible. On the contrary, Figuet, Humblot and Lahet (2015) found that Basel III could result in a 20 percent drop in cross-border banking claims held by international banks located in advanced economies on emerging countries, and that the European banking sector will be the most strongly impacted by the new standards. This was due to discrepancies in when and to what extent the jurisdictions had implemented the previous Basel recommendations. More specifically, the European Commission adopted directives with the Basel ratios as early as 1996, whereas other countries such as the United States, Basel II was only recommended for around twenty of the largest commercial banks and they had until 2008-2010 to comply with these rules. Additionally, in the early 2000s, European banks were involved in foreign claims on emerging market countries to a larger extent than US or Japanese banks, which further explains the differences in the impact of the Basel Framework on these banks (Figuet, Humblot and Lahet, 2015).

Basel III and its Implications on Swedish Banks

Under the currently effective Basel III Framework, banks are required to hold 8 percent of RWA, of which 4.5 percentage points needs to be Common Tier Equity (CET1). CET1 constitutes common shares issued by the bank, stock surpluses, retained earnings, accumulated comprehensive income and other disclosed reserves (Bank of International Settlements, 2021). Moreover, banks are required to hold additional capital upon the supervisor's judgement (AT1), as well as a variety of CET1 buffers to control for countercyclicality, systematically important institutions, and capital conservation. The capital requirements for the largest Swedish banks as of Q2 2022 were in the range of 17.8 to 18.1 percent of RWA (Finansinspektionen, 2022). For more information, see *Appendix 1: Capital Requirements, three major banks*.

Naess-Schmidt et al (2020) found that Basel III affects Swedish banks to a larger extent than their EU peers, whereas there is little to no evidence that the Swedish banking sector should be particularly vulnerable to justify this increase in capital requirements. On the contrary, the Swedish banking sector has historically had extremely low credit losses compared to the EU average, and in the European Banking Association's stress tests the Swedish banking sector comes out at the top; even in a scenario with a severe economic crisis. As a result, the capital requirements under Basel III may further increase the distance between capital requirements and the underlying risks of Swedish banks' portfolios, and thus the higher capital requirements damage Swedish banks proportionally more (Naess-Schmidt et al., 2020).

2.2. Performance of Banks Operating in Foreign Markets

Research on the field of foreign bank performance remains patchy; a summary of 35 studies on the topic reveals that fifteen find that foreign banks perform better than domestic banks on measures including return on equity, return on assets, profit efficiency and cost efficiency, whereas nine studies found worse or no statistically significant difference on these measures. The remainder of the studies are ambiguous and show that foreign banks tend to perform better than domestic banks on some measures, and on others worse or equal (Claessens and van Horen, 2012).

More specifically, Claessens and van Horen (2012) found that foreign banks may well have several advantages over domestic banks; catering clients in multiple countries allow foreign banks to benefit from efficiency and scale gains, as well as diversify their risks better. At the same time, foreign banks are likely to face greater challenges compared to domestic banks. This is due to foreign banks typically having less local knowledge than domestic banks on how to conduct business in the host country, or they are exposed to unfair treatment by the host country's government (Claessens and van Horen, 2012). For example, Wu and Salomon (2017) found that foreign banks operating in the United States are more likely to receive regulatory enforcement actions than similar US commercial banks. Additionally, diseconomies may arise due to difficulties in operating and monitoring the bank from a distance or due to cultural differences between countries (Wu and Salomon, 2017).

Certain factors seem to influence the performance of foreign banks. Claessens and van Horen (2012) found that foreign banks tend to perform better when they originate from a high-income country and when regulation in the host country is relatively weak. Not surprisingly, the authors also found that foreign banks tend to perform better when having a large market share and regulation in the host country is similar to that of the domestic country (Claessens and van Horen, 2012). Local market conditions also play a part; Miller and Eden (2006) found that local density, that is the number of firms vying for similar resources in the local environment, is negatively related to foreign subsidiary performance.

The differences between foreign bank performance seem to vary by jurisdictions and time periods. For instance, US foreign banks tend to perform worse than domestic banks. Deyoung and Nolle (1996) found that while foreign-owned US banks and domestic US banks were equally output efficient, the study showed that foreign-owned banks were less input efficient. This, in turn, was a result of foreign-owned banks not developing the relationships with US retail customers needed to achieve a critical mass of deposit funding, but rather having to finance their growth with expensive purchased funds. The authors also note that the low profits and low profit efficiency in foreign-owned banks may well be a result of foreign banks in the US focusing on maximizing market share in the 1980s, meanwhile their US counterparts focused on maximizing profits (Deyoung and Nolle, 1996).

Adding to this, Claessens, Demirgüc-Kunt and Huizinga (2001), as well as Micco, Panizza and Yanez (2007) found that foreign banks tend to have lower interest margins and profitability than domestic banks in developed economies, whereas the opposite is true in developing economies. This may be due to developed country banking markets being more competitive with more sophisticated participants, and that the potential technical advantages foreign banks have in these markets are not enough to overcome the informational disadvantages relative to domestic banks. Wu and Salomon (2017) also found that foreign firms tend to have higher operating costs. When it comes to overhead costs, however, Claessens, Demirgüc-Kunt and Huizinga (2001) found that foreign banks tend to have lower overhead expenses than domestic banks, since they mainly engage in wholesale transactions. Furthermore, Berger et al. (2003) argue that some banking services, including relationship lending to small companies and companies that value relationship-based financing, restrict financial globalization as these clients prefer banks that emphasize their local reach (Berger et al., 2003).

2.3. Recent Trends Affecting the Geographical Scope of Banking

Although there is evidence of rapid growth in trade and financial globalization during the postwar period, this trend seems to have decelerated in the wake of the global financial crisis (Cerutti and Zhou, 2017; James, 2018). Following the crisis, many banks reorganized their business models and international strategies by withdrawing from several markets, not least to reduce the risks associated with a complex international organization. A sharp reduction in European banks' cross-border lending activity led to a reduction in global cross-border lending, and at the same time, there was an increase in the number of lender-borrower connections within the same regions outside the main global banking systems (US, Euro Area, UK, and Japan), a phenomenon known as regionalization (Cerutti and Zhou, 2017).

Adding to this literature, Giannetti and Laeven (2012) have reported evidence of a “flight to home” or “flight to core markets” effect following the crisis, because of increased risk aversion or lower expected returns in overseas markets. Furthermore, increased capital requirements following the global financial crisis also had an adverse effect on cross-border banking. Shekhar et al (2014) found that a 1 percent increase in British banks’ capital requirements is associated with a reduction in the growth rate of cross-border credit of around 5.5 percentage points (Shekhar et al., 2014).

The trend may decelerate even further following the coronavirus pandemic (Kim, Shim, and Park, 2022). Although the economic evidence of deglobalization remains patchy and modest (James, 2018), recent research has found that trade integration positively affects financial integration, and the size of the effect is quite substantial. Thus, if events such as the coronavirus pandemic do accelerate trade deglobalization, it is reasonable to assume that financial globalization may be negatively affected as well. However, this effect may be offset by other factors, including the acceleration of financial globalization through fintech and information technology developments which have gained momentum during the pandemic (Kim, Shim, and Park, 2022). Similar to previous research on financial globalization (e.g., Mulder and Westerhuis, 2015), the evidence of deglobalization seem to vary between jurisdictions; McCauley, Bénétrix and McGuire (2019) found that following the global financial crisis, the global shrinkage of bank positions is driven by European banks, which responded to credit losses after 2007 by shedding assets abroad to restore capital ratios. Japanese, Canadian and US banks, on the other hand, have expanded their global footprint since 2007 (McCauley, Bénétrix and McGuire, 2019).

Although the European Union removed most of the regulatory borders between bank markets in the union (i.e., borders that limit a bank’s ability to, for instance, open branches in another country), other types of borders remain. For instance, Degryse and Ongena (2004) describe how exogenous economic borders including different legal systems, supervisory and corporate governance practices, as well as political, linguistic, and cultural differences between countries, endure and have an adverse impact on cross-border banking within the European Union. The differences in supervisory practices between countries are as large as the variation in the world, and variations in legal systems between bank markets create significant costs for banks. Furthermore, differences in political frameworks, languages, and cultures between European countries should not be underestimated (Degryse and Ongena, 2004). Further evidence that regulation may adversely impact cross-border banking activities is presented by Campa and Hernando (2004), who suggest that exogenous borders including regulation limits cross-border bank M&A activities.

2.4. Divestment Rationale

Previous research has examined why firms chose to divest their operations. The most significant predictor of divestment decisions seems to be poorly performing operations (e.g., Montgomery and Thomas, 1988; Hoskisson, Johnson and Moesel., 1994), as well as refocusing on core activities (e.g., Duhaime and Grant, 1984; Markides, 1992; Chang and Singh, 1999). Adding to this, Berry (2010) pointed out that firm growth and expansion strategies may involve both investments and divestments, and that investments providing more efficient uses of firm resources in foreign markets may also have an impact on firm divestment decisions (Berry, 2010). On the contrary, factors that have a negative relationship with divestment decisions, and thus make divestments less likely, are size, age, integration with other firm operations, sunk costs, and market growth and policy stability. As for the latter, high country growth seems to offset the influence of poor performance for related product markets, whilst the influence of this factor is less significant on poorly performing operations in unrelated product markets (Berry, 2013).

Additionally, Berry (2013) suggests that firms are significantly likely to divest their better-performing unrelated operations in countries with higher policy instability. This could be explained by the aftermath of divestments; since selloffs are the most common form of divestments, poor-performing operations may be a less attractive acquisition target in countries with less stable policies.

3. Methodology

3.1. The Case Study Method

Our methodology choice is based on the descriptive nature of our research question. The case study method has been explained by Yin (1994, pg. 13) as “research situations where the number of variables of interest far outstrips the number of datapoints”. While case studies may use quantitative data, a key difference with other research methods is that case studies seek to study phenomena in their contexts, rather than independent of context. This is appropriate when the researcher wants to gain insights into a real-world event and capture the dynamics in a single setting (Eisenhart, 1989). This approach was deemed suitable for our thesis, as it allows the researcher to develop a detailed understanding of the topic to explore a variety of factors (Flyvberg, 2011). The method is particularly fitting as we are examining a corporate strategic decision since the method has proven highly effective for generating and testing theory in the strategic management field (Gibbert, Ruigrok and Wicki, 2008).

3.2. Data Collection

Primary data was collected from written sources complemented by semi-structured interviews. The written sources include annual reports and financial statements, press releases, and other financial and statistical data published either by Handelsbanken, or another party including Jyske Bank, Factset, S&P CapitalIQ, and Yahoo Finance. The semi-structured interviews were held with employees at Handelsbanken and equity research analysts. The primary data was complemented with secondary data, including written reports, written equity research analysis and newspaper articles. The secondary data served both as preparation for the interviews, as well as case background material.

REFERENCE	INTERVIEWEE	TITLE	DEPENDENCE
SHB MANAGEMENT	Per Beckman	*Executive Vice President and responsible for the divestment of the Bank's operations in Denmark and Finland*	Dependent
	Carl Cederschiöld	*Chief Financial Officer and Executive Vice President*	Dependent
	Martin Noréus	*Chief Strategy Officer*	Dependent
	Lars Moesgaard	*Chief Executive Officer, Denmark*	Dependent
	Hanne Katrama	*Chief Executive Officer, Finland*	Dependent
	Peter Grabe	*Head of Investor Relations*	Dependent
	Lars Kenneth Dahlqvist	*Investor Relations Officer*	Dependent
EQUITY ANALYSTS	Anonymous	*Equity Research Analyst, Jyske Coverage*	Independent
	Anonymous	*Equity Research Analyst, Jyske Coverage*	Independent
	Anonymous	*Equity Research Analyst, SHB Coverage*	Independent

Table 1: Table presenting the interview subjects engaged in the data collection process. The table highlights the two case reference categories used in Section 4 in the thesis. The table also shows which stakeholders were either directly involved or could be assumed to have had the ability to influence the divestment decision (dependent), and those who did not (independent). For more details on the interviews and interviewees, see *Appendix 2: Interview List*.

Two groups of subjects were interviewed, namely employees that are part of, or co-opted to, Handelsbanken's management, and equity research analysts. The first group were stakeholders, directly or indirectly, involved in the decision to divest. The latter group were equity research analysts covering Handelsbanken, and/or Jyske Bank with extensive knowledge of the banks and their strategies. The primary inclusion criteria for the Handelsbanken group were heterogeneity between interview subjects, as we wanted the sample to show as complete and reflect as many aspects of the decision as possible to fulfill the construct validity criteria (e.g., Yin, 2014), meaning that the study tests what it is aimed to test. In addition, we interviewed Handelsbanken respondents on a dynamic basis, so that when the last respondents started to confirm the initial respondents' answers, we deemed our sample to provide sufficient security to analytically generalize the results (Yin, 2014). No Handelsbanken manager that were deemed relevant to participate and thus contacted, declined to participate.

To further enhance case nuance and completeness, we chose a balanced mix between dependent and independent sources. For the equity research analyst category, a small sample was selected by browsing the analyst coverage lists of Handelsbanken and Jyske Bank. Four analysts from different equity research firms and, to the extent it was possible, with different stock ratings[2], were contacted via email. Out of these, three stated a willingness to participate.

Our interview questionnaire followed an iterative process. We started by interviewing members from Handelsbanken's management to understand the holistic aspects of the decision, and to later develop predictions what subsequent interviews would suggest. After that, we pivoted each interview question to fill in knowledge gaps or asked about our initial findings to confirm these. The participants were sent the questions a few days in advance of the interviews, with the possibility to decline to answer or ask for clarification.

The interviews were held in-person, or digitally due to geographic limitations, throughout September and October 2022. The interviews followed a semi-structured approach which allowed for a deep understanding of the respondents' attitudes by allowing the questions to be answered freely and dynamically, while the interviewer could be active but not influencing (Bell, Bryman and Harley, 2018). We also achieved a deeper understanding by varying follow-up questions at the level of detail and asking for specified examples. All interviews lasted between 30 to 60 minutes and took place one time, except for interviews with Per Beckman that occurred twice. The data was recorded digitally with participants' consent and later transcribed, in line with the reliability criterion (e.g., Yin, 2014), as it ensures the stability of the results.

Some of the interviewees asked to be anonymized in the published version of our thesis, whereas some asked not to be quoted directly despite being willing to disclose their identity. To protect the integrity of our interviewees, we have chosen to refer to primary data collectively, unless otherwise stated. The reference "SHB Management" refers to data provided by one or several subjects representing Handelsbanken, and the reference "Equity Analysts", refers to data provided by one or several equity research analysts.

[2] Such as buy, sell, or hold.

3.3. Research Criticism

There are some weaknesses in our case study rigor concerning the four quality criteria developed by Yin (1994) and calibrated by Gibbert, Ruigrok and Wicki (2008). First, the case study methodology itself has been criticized in terms of external and internal validity. As for the former, the method has been criticized for being too subjective and providing little basis for generalization (Lincoln and Guba, 1985). Despite hindering statistical generalization, the method does allow for analytical generalization, meaning it can be generalizable to the theories on which they are based (Yin, 1994). One important tool to ensure generalizability is to design the research question so that it asks “how” or “why” (Yin, 2014), which we have done. As for internal validity, the case study method has been criticized for being prone to researcher bias, affecting what data is incorporated in the study and potential bias in respondents' recollections of events. We partly compensated for this by interviewing equity research analysts who serve as independent sources in the divestment decision and triangulating the data (Strauss and Corbin, 1994; Yin, 2014) with other data collection methods such as financial analysis.

Third, there is an apparent sensitive nature of the research question and the timing of data collection given that Handelsbanken’s deal with Jyske Bank regarding their Danish operations was still pending closing by the time interviews were conducted and that a buyer has not yet been announced for the Finnish operations. This may have impaired the scope to which Handelsbanken employees were able to answer our questions and restricted our access to internal data from the Bank. Instead, we had to rely on external sources to a larger extent. This may have had a negative impact on the study’s construct validity, meaning the degree to which a method measures what it claims to measure.

Lastly, our anonymization of sources as well as the bulky coding of interviews in two groups, “SHB Management” and “Equity Analysts”, interfere with the study’s construct validity and reliability. Given this, one cannot trace the data fully and replicate the same case, particularly due to the wide range of views among equity analysts. On the other hand, we defend anonymization since it benefits the study’s construct validity given the sensitive timing of the research question, as we could obtain access to more participants and they could speak more freely, thus providing more nuanced data.

4. The Case

4.1. Handelsbanken and its History

4.1.1. Introduction

<u>*Handelsbanken Overview*</u>

Handelsbanken was incorporated as a local bank in Stockholm in 1871. By 1919, the Bank had expanded its branch network throughout Sweden and operated as a nationwide bank. Following the appointment of Jan Wallander as Chief Executive Officer in 1970, Handelsbanken underwent a significant organizational restructuring. The new organization focused on profitability rather than volume, with a goal of achieving a higher return on equity than the average of comparable peers. This goal was to be achieved by having higher customer satisfaction and lower costs than competitors, which in turn was made possible by a largely decentralized organization where decision-making authority was transferred from central headquarters to eight regional banks (Handelsbanken, 2022a). This supported Handelsbanken's idea that business decisions should be taken close to the customers; to deliver better service, greater effectiveness, and higher quality credit decisions. The approach proved successful, and since the early 1970s, the Bank has delivered a higher return on equity than the average of comparable peers. For many years, Handelsbanken has also been one of the most cost-efficient universal banks in Europe with a significantly lower loan-loss ratio than its competitors. This is primarily attributable to the fact that each branch manager is held accountable for their credit decisions, which requires fundamental knowledge of the customer and therefore lowers the risk of credit losses. As a result, Handelsbanken has also shown the highest level of customer satisfaction of the four largest banks in Sweden ever since the surveys began (Handelsbanken, 2007; Handelsbanken, 2022a).

Today, Handelsbanken provides a full range of banking services to private, corporate, and institutional customers. In total, they have around 20 percent of the Swedish deposit and lending market share, making them one of Sweden's largest banks. The Bank's branches are supported by central units with expertise within each business area as well as central support functions including departments for compliance, communication, new digital platforms and more. Through Handelsbanken Capital Markets, the Bank also operates in investment banking, research, asset management, financial institutions, and global banking (Handelsbanken, 2022b; Nilsson and Cotten, 2022).

Expanding Beyond Sweden

In the 1970s and 1980s, an increasing number of countries relaxed their financial market regulations. The deregulation was largely a result of a changing market environment; new technology enabled the scaling of international transactions, and the transition to a variable exchange rate in many countries facilitated the free movement of capital across countries with monetary policy autonomy. The winds of change ultimately reached the Nordic countries including Sweden. In 1985, interest rate regulation and the loan cap were abolished in what was commercially called "the November Revolution". This augmentation allowed Swedish banks to sell parts of their bond portfolios, which in turn caused a sharp increase in their lending (Sveriges Riksbank, 2022). A few years later, Swedish foreign currency regulations were lifted, and it had also become possible for Swedish banks to open branches abroad (Handelsbanken, 2022a). As a result, Handelsbanken started exploring opportunities for international expansion.

Already in the early 1980s, the Bank had commenced operations in the UK. According to Handelsbanken's management, the Bank's plans to expand internationally during this period were not unique to the Bank itself, but rather part of an ongoing trend among Swedish banks that experienced a relatively saturated domestic market (SHB Management, 2022). This trend was further spurred by Sweden entering the European Union in 1995, which also increased competition from abroad (Farrell et al., 2006). A few years prior, in 1993, the European Union had implemented a directive allowing banks to operate within the same regulatory and competitive business environment. Additionally, the Union had established a standardized process to acquire a banking license, standardized supervision rules and standardized capital requirements (Berglund and Mäkinen, 2019; Schure, Wagenvoort and O'Brien, 2004). As a result, the general belief among Handelsbanken's management at this time was that this deregulation resulted in increased competition in European banking and unwrapped possibilities for Swedish banks to expand abroad (SHB Management, 2022; Equity Analysts, 2022).

As a natural first step, Handelsbanken investigated expansion opportunities within the Nordic region, since it was assumed that these markets had both cultural and political similarities with Sweden. Moreover, being able to serve clients in all Nordic countries was viewed as a hygiene factor at the time, as many Swedish banks were expecting their customers to follow the trend of Nordic expansion. This supported the idea of expanding to all Nordic countries (SHB Management, 2022; Equity Analysts, 2022). As a result, in 1989, the Bank opened its first branch in Norway; this was followed by Finland in 1991, and Denmark in 1996. A few years later, in 1998, the branch operations in Norway, Finland, and Denmark gained the status of separate regional banks, after which their business was run on the same principles as in Sweden. Whilst many other Swedish banks were exploring the possibility of expanding into the former Soviet Union States in the 1990s, Handelsbanken focused on countries with stable political systems and cultural similarities to Sweden. Expanding into countries with a decent rule of law would minimize the political risk and thus enable a safer credit process, in line with Handelsbanken's low-risk policy (SHB Management, 2022). In 2002, Handelsbanken named the United Kingdom their fifth home market. The same year, Handelsbanken opened its first branch in the Netherlands, which was named a home market in 2013 (Handelsbanken, 2022a).

In the Annual Report of 2006, Handelsbanken described itself as the "most international Nordic bank", with branches and/or representative offices in 15 countries outside the Nordic region and the United Kingdom. These functions operated under the department Handelsbanken International (Handelsbanken, 2007). Pär Boman, then Chief Executive Officer, commented on the Bank's international expansion:

> "*A vital task for Handelsbanken International will be to increase the number of markets in which the Bank can start up and grow organically by running profitable universal banking operations through its own branch network. And the Bank will continue to grow internationally – and even more quickly than before*."
>
> – Pär Boman, Handelsbanken, 2007 (p. 7)

Despite being a relatively unknown bank outside of Sweden, Handelsbanken meant that their business model was relatively easy to export to other markets. Their decentralized organization led to high customer satisfaction, something which was also true for Handelsbanken's international operations and facilitated organic growth (Handelsbanken, 2007). By the end of 2019, Handelsbanken operated as a Nordic universal bank with 800 branches, divided into six home markets organized in 14 regional banks and an international branch network in 20 countries (Handelsbanken, 2020a).

4.1.2. Declining Profitability in the Handelsbanken Group

Diminishing Return on Equity and Cost Efficiency

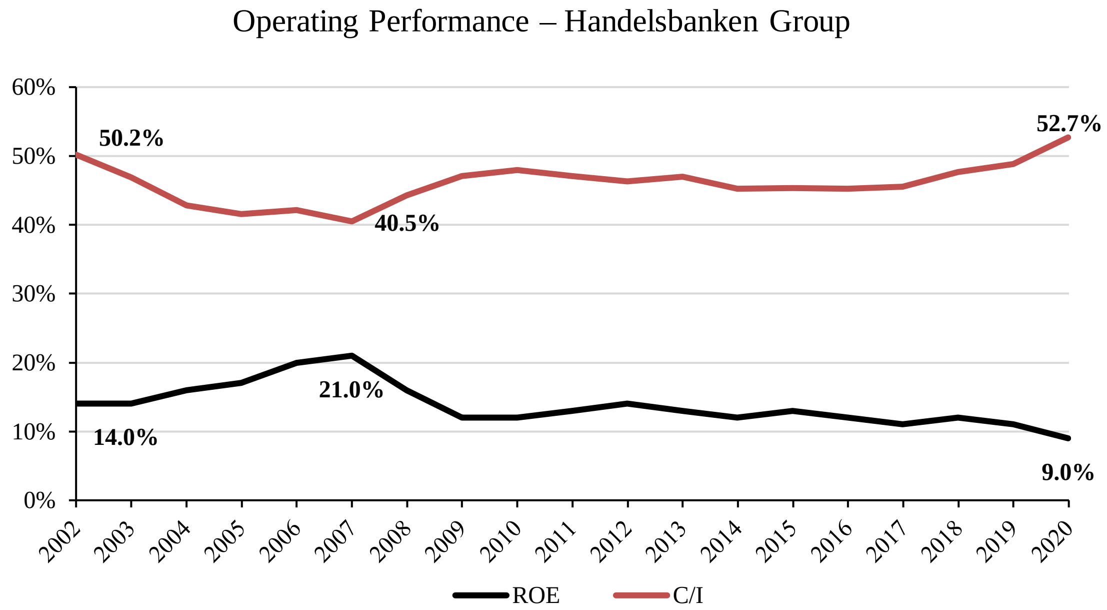

Figure 1: Illustration of the negative relationship (-0.82) between return on equity (ROE) and cost-to-income (C/I) ratio with callouts on years 2002, 2007 and 2020. ROE data is retrieved from annual reports and calculated as the year's net profit after loan losses to average total shareholder's equity by fiscal year-end. Please note, this calculation diverges slightly from Handelsbanken's reported ROE that is adjusted for factors including value changes on financial assets, derivatives, and more, since these adjustments have varied over time according to equity research analysts, thus making the numbers less comparable.

Before 2008, Handelsbanken had displayed a strong development in its core operating profitability metric, the cost-to-income ratio ("C/I ratio"). The cost-to-income ratio gauges how well a bank generates operating income, consisting of net interest and net commission revenue, in relation to its operating expenses, including staff costs, IT costs, internal purchases, and depreciation and amortization. This ratio was superior to peers; Handelsbanken had a cost-to-income ratio of around 45 per cent, while peers had cost-to-income levels closer to 50 per cent. Given that Handelsbanken's loan losses historically have been close to zero (on average 100 basis points as a percentage of total lending), the operating profit has closely reflected net income. This, in combination with a relatively intact capital structure, resulted in a strong negative correlation between the two metrics with return on equity increasing in line with a decreasing cost-to-income ratio.

However, after the global financial crisis, the Group's strong track record in cost efficiency and profitability weakened. Handelsbanken experienced an upwards trend in the cost-to-income ratio, and a significant drop in return on equity, which also displayed a downward trend in the following years in line with the rising cost-to-income ratio. Analysts were becoming increasingly concerned about the declining profitability of the Bank, and the fact that Handelsbanken's costs were increasing at a faster pace than its revenue (Equity Analysts, 2022).

Increased Regulatory Requirements

The increase in the cost-to-income ratio and decrease in return on equity displayed in Figure 1 could partially be explained by strengthened regulatory requirements, especially following the financial crisis. Increased capital requirements forced banks to hold a larger capital base, which all else equals lower the return on equity. One equity research analyst even commented that "banks will never achieve the same return on equity as they did before the financial crisis", given that every additional percentage of capital banks needed to hold inhibits the strong leverage effect banks so strongly profit from (Equity Analysts, 2022).

Already in 1988, Basel I was issued which specified how much capital banks need to hold for their total assets. This was superseded by Basel II in 2004 which aimed to calibrate the method of calculating the risk-weighted assets that the capital requirements are based on. This allowed banks, if permitted by the regulatory supervisor (in the Swedish case, Finansinspektionen), to use their internal credit-risk models to evaluate the required capital. However, the global financial crisis revealed that many banks did not have assets of adequate quality on their balance sheets to compensate for expected loan losses. As a result, the Basel Committee released a set of enhancements in the form of Basel III, which contained more stringent regulation on specific issues such as the risk for bank runs, and adjustments for systematically important, “too-big-to-fail”-institutions by additional capital requirements (Bank for International Settlements, 2021).

These increased capital requirements resulted in Handelsbanken being required to hold more capital for their assets. For example, the Bank’s required capital reserves of Tier 1 capital went from six percent under Basel I, to around ten percent under Basel II. Under the currently effective third accord, Handelsbanken’s Tier 1 capital requirement as of Q4 2020 was 13.8 percent. Handelsbanken has a goal of exceeding the requirements with one or two percentage points but has historically kept an excess buffer of around three to four percentage points. Nonetheless, according to Handelsbanken’s management, Basel II was actually rather favorable to the Bank in terms of risk models due to their inherently risk-averse business model. Since the internal model used to calculate credit risk is partly based on historical credit losses, and since these were close to zero in Handelsbanken, their risk-weighted amount was, all else equal, lower than comparable banks (SHB Management, 2022). This was communicated in the Annual Report 2007 as:

> *“The method used means that the Bank’s historical – and low – losses have a direct impact on risk calculations and capital requirements, which contributes to the positive outcome for the Bank of the new capital adequacy regulations”*
>
> – Handelsbanken, 2008 (p. 46)

Additionally, regulations on liquidity requirements, resolution buffers, GDPR, MiFID I and II, and anti-money laundering directives have all contributed to higher regulatory costs for banks (SHB Management, 2022; Equity Analysts, 2022). This is mainly attributable to banks being forced to increase their costs associated with compliance, risk, and similar functions, which are not directly contributing to any income and thus, all else equal, increase costs and thereby also the cost-to-income ratio. Furthermore, regulations are often applied slightly differently across jurisdictions. For instance, Basel III allow the domestic regulator to set out additional requirements on top of the minimum requirements. These additional requirements vary between countries and are one of the reasons why Swedish banks tend to be more well-capitalized than their peers (Nilsson and Cotten, 2022). Whilst the European Union has historically attempted to standardize financial regulation, standardization often leads to more layers of legislation rather than less. This is due to regulatory revision typically resulting in added legislation, as opposed to reducing the regulatory burden, so when the regulatory frameworks become more standardized they also become more extensive. As a result, Handelsbanken, like other Nordic banks, must adhere to both the domestic and local regulators, which requires local expertise and increases the responsibilities of local compliance functions. This ultimately increases overhead costs in each jurisdiction and limits economies of scale for a bank's cross-border presence (SHB Management, 2022; Equity Analysts, 2022).

Changing Consumer Behavior and Accelerated Digitalization

The increased regulatory burden also forced Handelsbanken to integrate these requirements into their IT systems to monitor the risks. As opposed to newly incorporated niche banks that can employ the most recent technology that already adheres to these standards, Handelsbanken instead needs to integrate these changes into already established IT infrastructure which can be cost inefficient. An additional layer of complexity was that Handelsbanken, like many other Nordic banks, did not have a unified cross-country platform that could be levered in an expansion. Instead, the Bank had different IT systems in different jurisdictions, which was both a result of local discrepancies in compliance requirements as well as the IT systems having been incorporated in these markets at different points in time. Since the IT systems vary between jurisdictions, significant investments were required in each market to implement these requirements, which further limits economies of scale across markets (SHB Management, 2022; Equity Analysts, 2022).

Regulatory compliance was however not the only factor that required increased investments in IT. The digitalization of society has resulted in customers conducting many of their banking errands online as opposed to visiting their local branch offices. Disruptors in the form of niche actors in the fintech industry have challenged traditional banks and their business models, as their digital offerings enabled cost-cuttings and provided customers with price-worthy alternatives (Equity Analysts, 2022). Even though Handelsbanken was making investments in IT and digitalization at the time, they still argued that their wide branch network gave them a competitive edge at a time when many other banks reduced the number of physical branches (Handelsbanken, 2019d). Analysts, on the other hand, were becoming increasingly concerned that Handelsbanken was lagging behind other large banks in terms of digitalization, and that their traditional branch network was not only costly but also becoming increasingly obsolete in the digital society (Equity Analysts, 2022).

4.2. Concentrating the Bank

4.2.1. A Change of Direction

On February 18th, 2019, the Board of Handelsbanken announced that it had appointed Carina Åkerström as the new President and Group Chief Executive (Handelsbanken, 2019a). Åkerström formed a new Executive Management Team and started to overlook the Bank's declining cost efficiency. During her first year in office, several divestments of Handelsbanken's international operations were communicated, including Estonia, Latvia and Lithuania, as well as Poland. The decision to divest these operations was motivated by low profitability and changing customer behavior requiring significant investments to remain relevant in these markets (Handelsbanken, 2019b; Handelsbanken, 2019c). Åkerström also communicated that the Bank would focus on two core areas, financing and savings, as opposed to being a universal bank (Handelsbanken, 2020a).

Divesting these international operations was, however, only a part of Handelsbanken's restructuring to become a more cost-efficient bank. To combat increasing costs, changes also had to be made in the Swedish organization, and in September 2020 Handelsbanken announced that they were to close 180 of its 380 branches by the end of 2021. Similar to the previous international divestments, this decision was motivated by changing customer needs as a result of digitalization and the need for specialist expertise on the branch level; yet in fewer locations. Accordingly, Handelsbanken announced an investment of SEK 1 billion in IT over the next two years, to enhance its digital customer offering, and a cost cap of SEK 20 billion was to be achieved by the end of 2022 (Handelsbanken, 2020b).

4.2.2. A More Focused Bank

Another year passed by and Handelsbanken was starting to see the effects of its cost-cuttings (Handelsbanken, 2021a), and total shareholder return held up against index (see *Appendix 3: Total Shareholder Return*). Yet, there was still more to be done to enhance shareholder value. Handelsbanken was now looking into the remains of their international branch network to assess which units that still fit into their new, focused strategy. Apart from Sweden, Handelsbanken still had an international presence in five other home markets, the United Kingdom, the Netherlands, Norway, Denmark, and Finland. According to Handelsbanken's management, they asked themselves two questions in evaluating which units to keep; (i) which units have had the best historical performance, and (ii) which units have the best potential for future growth and profitability?

4.2.3. Evaluating the Historical Performance of Each Geographical Segment

Cost-to-Income Development per Segment

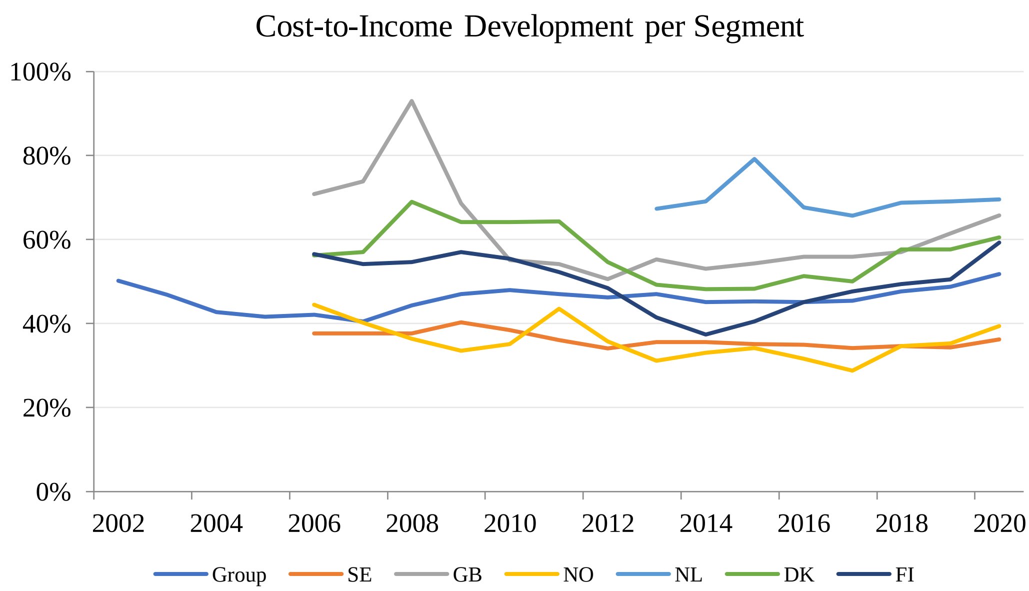

Figure 2: Illustration of the (operating) cost efficiency of Handelsbanken Group since 2002 and remaining home markets since 2006. Please note that the spikes in the cost-to-income ratio in particular markets and years refer to unusual items, including effects relating to the global financial crisis and the European debt crisis. The data is retrieved from annual reports.

Handelsbanken's subsidiary in the United Kingdom had shown a cost-to-income ratio that was well exceeding the other units in the group. This was attributed to a variety of factors, including an aggressive expansion strategy, the integration of acquisition target Heartwood in 2013, and the restructuring of the branch into a subsidiary in 2015 (SHB Annual Reports, Equity Analysts, 2022). Furthermore, in 2017, Handelsbanken received criticism from the Financial Conduct Authority (FCA) in the United Kingdom for "serious weaknesses" in combating financial crime. As a result, the FCA required Handelsbanken to appoint a "skilled person" to assess the quality and effectiveness of the financial crime network and to consolidate the remediation (Hägerstrand, 2018; Milne and Arnold, 2018). Naturally, this increased the costs associated with this unit and limited the resources available to increase business volumes during the remediation period (Equity Analysts, 2022). Similarly, the Netherlands also displayed a high cost-to-income level. This was in part attributable to this unit being relatively newly established; Handelsbanken commenced operations in this market in 2013 and acquired the wealth and asset manager Optimix in 2016 to widen their product offering in the Netherlands. However, it is also important to note that British and Dutch banks tend to have higher cost-to-income ratios than the average of Swedish banks, due to divergences in these markets compared to Sweden (SHB Management, 2022; Equity Analysts, 2022).

On the contrary, both Sweden and Norway demonstrated cost-to-income ratios that were well below the average for the group. Norway experienced a slight increase in the ratio in 2011, which was attributable to a change in regulation that increased pension costs. Despite being best-in-class in terms of cost-to-income ratio within the group, both Sweden and Norway displayed a negative trend in this ratio from around 2017 onwards. In Finland, the cost-to-income ratio increased significantly after the global financial crisis. This was largely due to IT investments to change the core banking system, which also required an increase in staff costs due to hiring consultants (SHB Management, 2022). Similarly, Denmark also experienced an increase in their cost-to-income ratio because of IT investments and regulatory costs (Equity Analysts, 2022).

Peer Comparison – Handelsbanken and its Home Markets

Handelsbanken's performance during this time could also be evaluated against its competitors in each of its home markets. Table 2 summarizes the performance of Handelsbanken's segments and their respective peer groups during the financial year 2019[3] across several metrics typically used in bank valuation. When investors are gauging bank operating performance, the single two most common ratios to focus on are the cost-

[3] 2019 was deemed appropriate as a benchmarking year since this was prior to the strategic repositioning decision, and thus provides insight into the context in which management evaluated all markets.

to-income ratio and return on equity. Other metrics are nonetheless also important in evaluating bank performance, including the net interest margin which reveals how much the bank earns on interest on its loans compared to how much is paid in interest on deposits. Credit losses also constitute a vital part of bank valuation, captured by both the credit loss ratio and the net profit after loan losses, where the latter is reported in our table as profit margin including loan losses (Damodaran, 2009). Additionally, the common equity tier 1 ratio (CET1-ratio) indicates potential discrepancies in the banks' capital structure, and the price-to-book indicates the multiple to which each bank trades on. For detailed calculations on each measurement, see *Appendix 4: Detailed Calculations for Peer Comparison*.

	Net Interest Margin	C/I Ratio	Profit margin (Incl. Loan losses)	Credit Loss Ratio	Adj. ROE (ROAC)	CET1 Ratio	P/BV
SHB Group	**1.4%**	**48.8%**	**48.8%**	**0.04%**	**10.8%**	**18.5%**	**1.3x**
SHB Sweden	**1.3%**	**34.4%**	**66.8%**	**0.08%**	**14.0%**		
Peer average	*1.4%*	*55.7%*	*39.5%*	*0.12%*	*10.4%*	*17.1%*	*1.0x*
Danske Bank	1.2%	64.8%	30.7%	0.08%	9.3%	17.3%	0.6x
Nordea	1.4%	69.0%	24.5%	0.17%	4.9%	16.3%	0.9x
SEB	1.3%	45.8%	49.7%	0.12%	13.0%	17.6%	1.2x
Swedbank	1.6%	43.0%	53.1%	0.09%	14.3%	17.0%	1.1x
SHB UK	**2.4%**	**61.5%**	**38.9%**	**-0.01%**	**13.3%**		
Peer average	*2.8%*	*58.9%*	*30.6%*	*0.33%*	*9.3%*	*14.6%*	*0.8x*
Barclays	2.8%	63.0%	26.9%	0.56%	7.7%	13.8%	0.6x
HSBC	3.0%	59.2%	24.1%	0.27%	8.4%	14.7%	0.9x
Lloyds	2.7%	48.5%	41.6%	0.29%	12.9%	13.8%	1.0x
NatWest	2.5%	65.1%	29.7%	0.21%	8.2%	16.2%	0.8x
SHB Denmark	**1.6%**	**57.6%**	**44.1%**	**-0.01%**	**12.0%**		
Peer average	*2.4%*	*59.5%*	*38.9%*	*0.05%*	*9.6%*	*16.4%*	*0.9x*
Danske Bank	1.2%	64.8%	30.7%	0.08%	9.3%	17.3%	0.6x
Jyske Bank	1.2%	62.8%	38.2%	-0.02%	8.6%	17.4%	0.6x
Ringkjøbing Landbobank	3.4%	38.0%	58.8%	0.28%	12.0%	15.0%	1.8x
Spar Nord Bank	3.8%	60.3%	39.0%	0.05%	10.9%	14.6%	0.9x
Sydbank	2.4%	71.7%	27.9%	-0.16%	7.3%	17.8%	0.7x
SHB Finland	**1.0%**	**50.5%**	**58.9%**	**-0.09%**	**13.3%**		
Peer average	*1.6%*	*68.2%*	*28.4%*	*0.08%*	*8.8%*	*15.4%*	*0.9x*
Danske Bank	1.2%	64.8%	30.7%	0.08%	9.3%	17.3%	0.6x
Nordea	1.4%	69.0%	24.5%	0.17%	4.9%	16.3%	0.9x
Ålandsbanken	2.4%	73.0%	24.8%	0.08%	10.7%	13.4%	1.0x
Aktia Bank	1.2%	66.0%	33.8%	0.00%	10.3%	14.7%	1.1x
SHB Norway	**1.5%**	**35.3%**	**64.4%**	**0.02%**	**12.0%**		
Peer average	*2.2%*	*43.9%*	*54.9%*	*0.13%*	*10.6%*	*17.5%*	*1.1x*
DNB	2.4%	42.2%	56.9%	0.13%	11.3%	18.6%	1.2x
SR Bank	2.0%	41.0%	58.5%	0.11%	10.8%	17.0%	1.1x
Ostlandet	2.1%	45.0%	54.2%	0.03%	10.2%	17.2%	1.0x
SMN	2.2%	47.3%	49.9%	0.24%	10.2%	17.2%	1.1x
SHB Netherlands	**1.6%**	**69.1%**	**30.6%**	**0.01%**	**11.8%**		
Peer average	*2.9%*	*54.9%*	*32.9%*	*0.48%*	*8.7%*	*14.8%*	*0.7x*
ABN Amro	2.4%	61.2%	31.1%	0.25%	10.0%	18.1%	0.8x
ING	2.3%	56.6%	37.3%	0.18%	9.0%	14.6%	0.8x
Santander	3.9%	47.0%	30.2%	1.01%	7.3%	11.7%	0.6x

Table 2: Peer comparison of Handelsbanken and its segments as of 2019. Data is retrieved from Factset and annual reports. The peer groups have been determined in cooperation with equity research analysts. Please note, since Handelsbanken's home markets do not have any own equity, the measurement return on allocated capital (ROAC) is used as a proxy for comparing these units against the return on equity (ROE) for other banks.

Handelsbanken as a Group performed better than Swedish peers in 2019 on several key ratios. The Bank displayed a net interest margin that was largely in line with peers, but had a higher profit margin, return on equity and price-book multiple. On the other hand, Handelsbanken operated with a lower cost-to-income ratio and credit loss ratio.

Noteworthy is nonetheless that Handelsbanken held more capital than its peers, with a CET1 ratio of 18.5 percent compared to the peer average of 17.1 percent.

Handelsbanken's UK and Dutch operations had a lower net interest margin and a higher cost-to-income ratio than peers. However, the profit margin in the UK was significantly higher than peers, and the credit losses were significantly lower. In the Netherlands, Handelsbanken also had a lower credit loss ratio, yet the profit margin was slightly lower than the peer average. In both these markets, Handelsbanken's return on allocated capital was higher than the peer groups' return on equity. While it can be noted that the peer groups in these two markets mainly consist of banks of a significantly larger size than Handelsbanken's operations, it is evident that both the UK and Dutch operations have a relatively low cost-efficiency and profitability in the form of net interest margin, although the profit margin including loan losses is either in line or above the average of peers.

In Denmark, Finland, and Norway, the net interest margin was significantly lower than that of peers. Noteworthy is also that compared to smaller local Danish banks, such as Ringkjoebing Landbobank and Spar Nord Bank, Handelsbanken's net interest margin was significantly lower (1.6 percent compared to 3.4 percent and 3.8 percent, respectively). Additionally, in Norway and Finland, Handelsbanken seemed to retain a decent cost efficiency compared to peers, whereas the cost-to-income ratio in Denmark was largely in line with peers. Handelsbanken did retain a higher profit margin than its peers in all home markets, as well as a lower loan loss ratio. The return on allocated capital of the different Handelsbanken segments was also higher than the return on equity of comparable peers.

In conclusion, while Handelsbanken's cost-to-income ratio on a group level was rather low compared to peers, it was clear that this was mainly driven by the Swedish operation's effectiveness. Out of Handelsbanken's other five home markets, only the Norwegian operations had a cost-to-income ratio that was in line with, or even slightly below, the Swedish operations. Compared to peers, however, the remaining home markets were relatively cost-efficient, apart from the United Kingdom and the Netherlands. Nonetheless, Handelsbanken had a lower net interest margin in all its home markets compared to peers, apart from the Netherlands. To improve its effectiveness in the other four markets, Handelsbanken would have to make significant investments. The remaining question was then, which markets have the best outlook for the future?

4.2.4. Evaluating Future Potential

Handelsbanken's expansion in the United Kingdom had historically been successful, with several new branches opening every year and stable growth in mortgage volumes (Handelsbanken, 2020a). Whilst some analysts were concerned about the increasing cost-to-income ratio in this unit (Equity Analysts, 2022), Handelsbanken had devoted significant resources to optimize the British business and make it more cost-efficient (SHB management, 2022). Handelsbanken's market share in the United Kingdom was small, but the potential was large; the Bank had a good track record of being an excellent private bank in the premier segment of the market, and the potential within Private Banking was considerable. Handelsbanken also had a strong position within the area of corporate financing and saw this as particularly attractive in accordance with the Bank's focused strategy (Handelsbanken, 2021b). Altogether, Handelsbanken's senior management considered the United Kingdom to be a market with strong future potential and suitability with their new, focused strategy (SHB Management, 2022).

Similar to the United Kingdom, the Netherlands was also a market where Handelsbanken considered the potential to be strong. According to Handelsbanken's management, the client segment served in the Netherlands resembled that of the United Kingdom and the Bank provided a more focused offering within asset management and real estate financing (Handelsbanken, 2021b).

The other three international units were in close geographic proximity to Sweden; Norway, Denmark, and Finland. Norway has experienced far less consolidation than the other Nordic bank markets and still has around one hundred small local savings banks which are often part of larger alliances (Norges Bank, 2022; Kristiansen and Cotten, 2021). Although a fragmented market may pose a challenge for organic growth for a bank like Handelsbanken, the Norwegian market had not only demonstrated a strong performance within one of Handelsbanken's core business areas, financing, over the past years, but it also had a record-low cost-income ratio and thus proved severely operationally efficient (Handelsbanken, 2021a; Handelsbanken, 2021b). As a result, Handelsbanken in Norway was strongly profitable in the Norwegian market, and this unit was also deemed to be well aligned with Handelsbanken's focus on savings and financing (Handelsbanken, 2021b).

The Danish bank market is characterized by both larger banking groups, such as Danske Bank, Nykredit and Nordea, as well as many small local or regional savings banks. Historically, fragmentation in the Danish bank market has been high, but consolidation has gradually increased; during the last twenty years, the number of banks has decreased from 185 to 58. Even though some of these banks are publicly listed, the majority are owned by families or foundations, and thus do not necessarily have the same required return as public companies, which harms profit margins. The Danish mortgage system is a defining component of the financial sector in Denmark, and many customers keep their deposits in local and regional banks but obtain mortgage loans through mortgage companies like Totalkredit, which is a subsidiary of Nykredit. Following this, Denmark's four largest banks (Nykredit, Danske Bank, Nordea and Jyske Bank) control around 70 percent of the domestic lending, but a smaller proportion of the deposit market (Cotten and Nilsson, 2021; Dengsø Nielsen, 2021). Recent M&A activity in Denmark is much higher than in any of the other Nordic countries, and consolidation is seen by many analysts as necessary to achieve scale. Handelsbanken did complete two acquisitions in the Danish market in 2001 and 2008, yet their market share remained small at around two percent. To grow further, Handelsbanken would have to invest heavily in M&A activities to obtain a larger share and profit from economies of scale (Equity Analysts, 2022).

The situation in Denmark resembled that of Finland in terms of future potential. The Finnish banking sector is dominated by four large banks, which control around 80 percent of the total market share together. The largest bank is OP Financial Group, which is made up of more than 140 independent cooperative banks and the OP Cooperative which together has a market share of around 35 percent. The second largest bank is Nordea Bank (25 percent market share), followed by Danske Bank which operates as a branch in Finland and Municipality Finance, which have around 10 percent market share each. Since Finland is a member of the eurozone, their three largest banks (Nordea Bank, OP Financial Group and Municipality Finance) are supervised by the European Central Bank.

Smaller Finnish banks are under the supervision of the Finnish Supervisory Authority (Somerla, 2021). For Handelsbanken, margins in this market were already under pressure and they struggled to obtain market share in this market without having to make severe investments or conduct acquisitions to grow scale economics (Handelsbanken, 2021b; Equity Analysts, 2022).

4.2.5. The Decision to Divest Denmark and Finland

<u>*Handelsbanken Announces Market Exists*</u>

Handelsbanken was due to release its interim report of Q3 2021 on Wednesday morning, October 20th (Handelsbanken, 2021c). However, the time of the release was changed with short notice a few days before the planned release, when Handelsbanken instead stated that the report would be released as soon as stock markets close on Tuesday evening of October 19th (Handelsbanken, 2021d). The Swedish financial newspaper Dagens Industri noted that this is likely due to the Bank releasing a crucial decision that has to be reported to the market as soon as possible in line with the regulation on market abuse (Hultgren, 2021).

By the time the stock market closed on Tuesday night, Handelsbanken released the Q3 report (Handelsbanken, 2021b). Investors, analysts and other stakeholders could read the message:

> *"Handelsbanken has today made the decision to cease its operations in Denmark and Finland. A process is being initiated to divest these two operations.*
>
> *[…]*
>
> *Nowadays, the conditions for running a profitable banking business in various markets are hugely different from how they were when Handelsbanken originally expended its geographical presence. The synergies become less and less potent as new regulatory frameworks are introduced, both locally and internationally, entailing that the Bank now needs central staff functions and infrastructure in each market. Customers have a greater appreciation for speed in restructuring and adapting to local conditions than they do for global products.*

> *'From a commercial perspective, we want to have a presence in those locations offering the best conditions for profitable growth and a strong market position. With this decision, we are strengthening the Bank's ambitions in our primary markets: Sweden, Norway and the UK,' says Carina Åkerström, President and Group Chief Executive of Handelsbanken.*
>
> *[…]*
>
> – Handelsbanken, October 19th, 2021[4]

Whilst the historical performance of the Danish and Finnish operations relative to peers as well as the Handelsbanken Group had been rather decent, Handelsbanken's decision to divest these two units was primarily a result of the expected future potential for these markets (SHB Management, 2022). Handelsbanken's investor relations officer, Lars-Kenneth Dahlqvist, commented on the decision as follows:

> *"We have long observed that the total banking market has a lower growth rate in both Denmark and Finland, compared to the banking market in Sweden and Norway. The United Kingdom and the Netherlands may have a lower cost efficiency today, but in these countries, we see great opportunities to increase our income significantly based on a cost basis that is not required to increase in the same pace as the income at all. This kind of future is not what we expect in Denmark and Finland, in part based on the above stated regarding the total market growth in these countries."*
>
> – Lars-Kenneth Dahlqvist, October 24th, 2022

Additionally, Handelsbanken deemed itself as being sub-scale in both Denmark and Finland. Lars-Kenneth Dahlqvist further commented on this issue:

> *"We also clearly see that the Bank of the future will require even greater investments in new digital technology and a prerequisite for being able to get a return on these investments is that the Bank has a certain size of operations in these countries, that is, there are simply necessary economies of scale in place."*
>
> – Lars-Kenneth Dahlqvist, October 24th, 2022

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[4] For full statement, see *Appendix 5: Press Release*

Handelsbanken’s management meant that the fragmented Danish market would require Handelsbanken to be part of a larger consolidation plan, something which would not only be difficult given the Bank’s track record of organic growth rather than M&A activity but also extremely costly. The Finnish market, on the other hand, is already very consolidated, and would thus require Handelsbanken to make significant investments to reach its desired market position. The relatively small size of these markets, in combination with the fact that market growth was considered as being limited, supported Handelsbanken’s prioritization of divesting these two units (SHB Management, 2022).

Together, the Danish and Finnish units of Handelsbanken accounted for around ten percent of the income, thirteen per cent of the costs and eight per cent of the operating profit within the Handelsbanken Group. The allocated capital in these operations amounted to around SEK 15 billion, of which around SEK 12 billion was Common Equity Tier 1 capital (Handelsbanken, 2021b). Equity research analysts covering Handelsbanken commented that the announcement to divest these two units was a well-awaited measure to cut costs within the Bank and that the fact that Handelsbanken released their plans on divesting these units before having found a buyer was in line with Åkerström’s promise to be a transparent Chief Executive Officer (Equity Analysts, 2022). Other reasons for announcing the divestment prior to finding a buyer were related to rules on market manipulation as well as the fact that many other parties, such as unions, were involved in the decision (SHB Management, 2022).

4.3. Handelsbanken Sells Danish Operations to Jyske Bank

To this date, Handelsbanken has not yet communicated that a buyer has been found for the Finnish unit. Thus, the following section will focus on the acquisition of Handelsbanken Denmark by Jyske Bank A/S.

4.3.1. Speculations Leading up to the Announcement

Six months post Handelsbanken’s announcement to divest the units, both Swedish and Danish newspapers started reporting that several large Danish banks were preparing offers for Handelsbanken’s Danish operations. The banks mentioned were Spar Nord, Nykredit, or possibly a joint offer by the two, as well as Jyske Bank (Hagemann-Nielsen and Elstrup, 2022; Nyhetsbyrån Direkt, 2022). At the time, none of the mentioned banks chose to comment on the rumors.

A few months later, on June 10th, Spar Nord announced that it was going to pay out the remainder of its dividend for 2021. Spar Nord had previously kept hold of this dividend should it be needed to strengthen the bank's own funds for potential acquisition in 2022 (Spar Nord, 2022), and thus analysts now ruled out Spar Nord as a buyer for Handelsbanken's Danish operations and instead put their odds in Jyske Bank's favor (Equity Analysts, 2022). Jyske Bank's share price closed 10.1 percentage points down on Spar Nord's announcement day, and according to analysts, this is partially likely due to concerns regarding the two banks using different IT platforms which were seen as a drawback in terms of synergies (Equity Analysts, 2022).

In response to these market rumors, Jyske Bank released an announcement on June 15th, stating that they were in discussions with Handelsbanken to acquire the Danish operations but that no agreement had been reached (Jyske Bank, 2022a). Handelsbanken released a similar statement a few hours later (Handelsbanken, 2022c). On June 20th, Handelsbanken announced that they had reached an agreement with Jyske Bank, who were to acquire all 43 branches and 600 employees of Handelsbanken Denmark, including more than 130,000 business relationships with private and corporate customers and assets, primarily comprised of loans, of around SEK 98 billion (Handelsbanken, 2022d; Jyske Bank, 2022b).

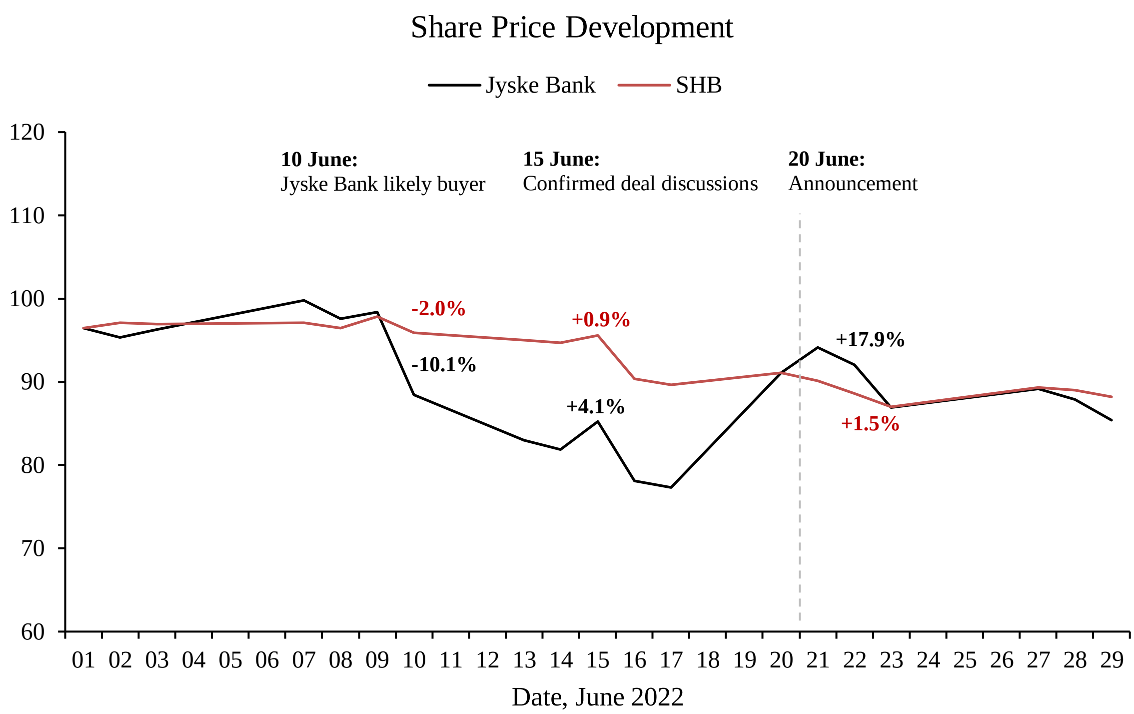

Figure 3: Illustration of Handelsbanken (OM:SHBA) and Jyske Bank's (CPSE:JYSK) share price movements around transaction announcement. Jyske share price is rebased to the one of Handelsbanken. Event dates are noted as the percentage change to prior day's closing price. Data are retrieved from Yahoo Finance.

Valuation of the Danish unit

Jyske Bank acquired Handelsbanken's business activities in Denmark for SEK 4.3 billion in goodwill in a pure asset deal. The transaction was structured through an asset sale since the Danish branch is run as a local branch, and not a legally defined subsidiary. Because of this, the unit does not have any own equity on which the purchase price can be based, and a fictive (book) equity amount needs to be established to derive an implied equity market valuation of the asset. This amount reflects how much capital Handelsbanken must hold for the assets included in the deal and is calculated as the goodwill and the common equity tier 1 capital for the unit. The latter is calculated as the risk-weighted exposure amount (RWA) for the Danish unit times the common equity tier 1 (CET1) ratio for the Handelsbanken Group. From Handelsbanken's perspective, the theoretical step-by-step approach to finding the implied price-to-book transaction multiple (excluding exit fees) can be calculated as:

$$\frac{P_{\text{implied}}}{B} = \frac{\text{RWA}_{\text{d}} * \text{CET1}_{\text{g}} + \text{P}}{\text{RWA}_{\text{d}} * \text{CET1}_{\text{g}} + G} = \frac{4.1+4.3}{4.1+2.6} \approx 1.25\text{x} \tag{1}$$

In which REA_d refers to the assets Jyske Bank are acquiring on a risk-weighted basis; $CET1_g$ refers to the common equity tier 1 capital the assets are binding for the group; G represents goodwill related to the Danish branch, and P denotes the premium.

Handelsbanken's Chief Financial Officer, Carl Cederschiöld, elaborated on the valuation in Dagens Industri following the transaction (Rex, 2022). The Danish unit contained an asset value of SEK 151 billion as of Q1 2022. However, Jyske Bank excluded some assets in the purchase, including central bank placements and some larger customer contracts (Handelsbanken, 2022b). On a net basis, the acquisition comprised assets of SEK 98 billion of which the risk-weighted exposure amount was SEK 22 billion. Handelsbanken's CET1 ratio was 18.7 percent as of Q1 2022 which was multiplied with the RWA to find the fictive Common tier 1 equity of SEK 4.1 billion for the Danish operations. Goodwill of SEK 2.6 billion, relating to the Danish operations, was added to the fictive equity as it belongs to the Danish operations by the legacy acquisitions of Midtbanken in 2001 and Lokalbanken in 2008. Regarding the price paid, a premium paid of SEK 4.3 billion was added to the purchase price (Rex, 2022). This results in a price-to-book ratio of around 1.25x. Nonetheless, the ratio must be adjusted for one-off costs relating to the transaction, including the penalty fee for exiting the contract with IT provider BEC. Adjusted for this, the price-to-book ratio according to Handelsbanken's Chief Financial Officer is slightly above 1.2x (Rex, 2022; Equity Analysts, 2022). For more information on Bank Valuation, see *Appendix 6: Bank Valuation.*

Given the assets were sold close to book value, the sale generated limited net profit for Handelsbanken. Instead, the deal increases the group's CET1 ratio from 18.7 to 19.4 percent. In the light of this, analysts have been questioning what Handelsbanken is going to use the excess liquidity for, yet Handelsbanken has not communicated any clear action than to invest it back in operations. However, there is some pressure for Handelsbanken to distribute the capital to shareholders given the already highly capitalized position (5.6 percent above CET1 regulatory requirement for 2021) and follow suit with other banks, such as Nordea, that in the most recent year has managed to increase its return-on-equity through its share buy-back program. The Chief Financial Officer Carl Cederschiöld commented on this topic as it is “not a problem for Handelsbanken to have excess liquidity in the short-term as we as a bank seek to have a capital structure that can sustain over the entire economic cycle” (Cederschiöld, 2022).

Strategic Rationale

In their press release following the announcement of the acquisition, Jyske Bank’s Chief Executive Officer commented on the acquisition:

> *”The acquisition of Handelsbanken Denmark is an attractive opportunity to strengthen our market position and long-term competitiveness. Handelsbanken Denmark is a well-run bank, delivering a strong suite of solutions to both private and corporate clients across the country. Through the acquisition, we can further develop the combined business, benefitting our clients, create new career opportunities for our skilled employees, and generate value for our shareholders.”*
>
> – Jyske Bank, 2022b

According to Jyske Bank, the acquisition of Handelsbanken would strengthen its market position, and result in an uplift of Jyske Bank’s market share of around 15 percent. This would in turn result in economies of scale and opportunities for Jyske Bank to strengthen its product and service offering (Jyske Bank 2022b; Equity Analysts, 2022). Additionally, the Danish bank meant that there was a good cultural fit between the two banks, underpinning the match between the two. Jyske Bank’s Group Strategy Officer commented on the deal:

> *”Jyske Bank has greatly appreciated a good, professional and constructive negotiation process, which has led to an agreement that is attractive for all parties. We look forward to welcoming Handelsbanken Denmark's clients and employees.”*
>
> – Jyske Bank, 2022b

However, some analysts were not as convinced that the deal was indeed attractive for all parties. Since speculations started after Handelsbanken’s divestment decision on October 19th, 2021, Jyske Bank’s share price performed poorly, which according to analysts was likely attributable to the two banks using different IT systems which required significant integration costs. Handelsbanken's customers and their client data were registered on a platform called BEC, whereas Jyske Bank's customers were registered on Bankdata. Migrating customers from one platform to another is typically associated with large costs, as well as exit fees for terminating one of the contracts prematurely. Moreover, Jyske Bank had a long history of buying back its own shares to increase EPS, something which they would not do this year due to the acquisition. Some analysts argued that the better scenario for shareholder value in Jyske Bank would be to just repurchase their own shares, as opposed to buying another bank's shares (Equity Analysts, 2022).

It was also unclear how the deal was going to be financed; and there was a possibility that Jyske Bank would have to issue new equity to bear the costs associated with the acquisition, which significantly depressed the share price (Equity Analysts, 2022). However, on the announcement day, Jyske Bank confirmed that Handelsbanken was to incur the full exit fee associated with the pre-termination of the contract with BEC, rumored to be around SEK 1.4 billion. Furthermore, Jyske Bank confirmed that the transaction would not require the Bank to increase equity share capital or dispose of existing treasury shares, and instead the plan was to issue AT1 and Tier 2 capital of around DKK 2.5 billion. This would largely be funded by covered bonds, supplemented with the issuance of senior non-preferred debt as well as traditional senior debt (Jyske Bank, 2022b). This was largely seen as a release by investors and analysts, and the share price jumped 17.9 percent on the announcement day. Despite this, some analysts were still skeptical towards the deal and how it affected shareholder value.

5. Discussion

5.1. External Factors: Regulatory Burden and Bank Market Discrepancies

Our findings reveal that Handelsbanken's divestment of the Danish and Finnish units was in part motivated by the presence of exogenous borders, such as different legal systems, supervisory and corporate governance practices, as well as differences in market structure as described by Degryse and Ongena (2004). Although both Denmark and Finland are in close geographical proximity to Sweden, differences in terms of regulation and discrepancies in the bank markets resulted in challenges for Handelsbanken to achieve scale in these markets to run a profitable business.

When Handelsbanken expanded to the Nordic countries in the late 1990s, they did so under the assumption that these countries had regulatory similarities to Sweden. However, reality soon showed that this was not necessarily the case; Handelsbanken experienced increased overhead costs in their overseas markets as a result of increased regulatory burdens in each country. This was largely a result of regulation being implemented differently across jurisdictions; whilst Denmark, Finland and Sweden are all subject to European Union legislation, any additional national legislation is then added on top of the supranational legislation. This layering of supranational and domestic regulation increases the requirements for local expertise and compliance functions in each market. This could be seen in the light of research by Claessens and van Horen (2012) on what factors influence the performance of foreign banks. The authors argued that foreign banks tend to perform better when regulation in the host country is similar to that of the domestic country. Though one could argue that regulation in the Nordic bank market is similar, the implementation differs between jurisdictions. This ultimately puts pressure on banks to increase their local compliance functions, which in turn requires banks to achieve a certain critical mass to be profitable in each country. This is also in line with Claessens and van Horen (2012), who argued that foreign banks tend to perform better when achieving a certain scale in the host market.

Another example of how bank regulation has impacted Nordic banks in recent years is that of Handelsbanken's peer Nordea. In 2018, Nordea announced that it was moving its headquarters from Sweden to Finland since Finland is part of the European Banking Union and thus part of a more predictable and less stringent regulatory environment. Prior to the move, the Swedish government had passed amendments to the banking regulations which would result in increased costs for Nordic banks in general, and Nordea in particular, due to its organizational structure. Similar to Handelsbanken's rationale of divesting the Danish and Finnish operations, Nordea meant that the move to a more predictable regulatory environment would allow them to increase investments in their digital offering. In other words, reducing the regulatory risk associated with presence in several jurisdictions seems to be of interest among Nordic banks, and may indicate a possible trend of decomplexifying the organizational structure.

Not only does regulation cause banks to refocus their operations, but differences in the local bank markets were also part of Handelsbanken's rationale for divesting the Danish and Finnish units. When Handelsbanken expanded internationally in the late 1990s, they argued that their business model was exportable due to its decentralized approach and subsequent closeness to the customer, which led to increased customer satisfaction and spurred organic growth abroad. Although this may well be true, one could still argue that Handelsbanken, similar to other banks expanding in the Nordics, underestimated the exogenous economic borders of these countries upon entering these markets.

This could be seen in the light of the findings by Canals (1997), who argued that commercial banking has a strong national component and that foreign banks need to achieve critical mass in their overseas markets to become profitable. Our findings show that the Danish bank market is severely fragmented with many small local banks and that the Finnish bank market is more consolidated yet mainly consists of banks that are owned by cooperatives or similar. It could thus be assumed that the national component of banking in these two markets is extra strong due to these market peculiarities, which may have placed Handelsbanken as a foreign bank at a further disadvantage compared to domestic peers. Furthermore, the local density of the bank market in Denmark may further have had a negative impact on Handelsbanken's performance in this market, in line with Miller and Eden (2006). The fact that Handelsbanken was sub-scale in these markets, and saw the future potential as being low, ultimately led to the decision to divest these two units.

In essence, our findings show that the regulatory burden associated with the presence in multiple jurisdictions, together with local discrepancies in the bank markets, could force banks to refocus on their core markets. Although the case study format limits our ability to make any general conclusions, one could reasonably assume that since regulation targets Nordic banks in similar ways, other pan-Nordic banks are impacted similarly to Handelsbanken by an increased regulatory burden. This could ultimately force a trend where Nordic banks are forced to refocus on their core markets, due to increased overhead costs and limitations of economies of scale in overseas markets.

5.2. Internal factors: Strategic Refocusing and M&A Crossroad

Despite this, it is important to note that the decision to divest the Danish and Finnish units was not only due to changing external environment but part of a strategic refocusing in Handelsbanken. Our findings reveal that Handelsbanken had a newly appointed management whose core focus was on making the Bank more cost-efficient. Further investments in the Bank's IT systems were needed, as well as investments in digitalization. As a part of this, Handelsbanken was conducting a strategic re-focusing on their core business areas, savings and financing, by reducing their branch network to focus more on specialized services as well as scaling down on their international operations to focus on markets deemed suitable to have future potential in these areas; Sweden, Norway, the United Kingdom and the Netherlands. This is in line with previous literature on divestments, where authors including Duhaime and Grant (1984), Markides (1992) and Chang and Singh (1999) found that divestment decisions are indeed often contingent on firms refocusing on core activities.

The Danish and Finnish units were both deemed to have a low future potential, relative to the Bank's other markets, as well as a relatively low correlation with the Bank's new focused offering. Whilst Handelsbanken has not yet communicated any plans on what to do with the excess capital from the sale of the Danish unit, it seems as if the plan is to reinvest the capital in the business to enhance the offering in the remaining home markets. Thus, one could assume that Handelsbanken considered the alternative cost for growth associated with making further investments in Denmark and Finland to achieve scale, as opposed to divesting these two units to release capital for making these kinds of investments in the remaining home markets instead. This supports the findings by Berry (2010), who addressed that divestments may also be part of firm growth strategies, as they make resources available for further expansion.

Our findings suggest that Handelsbanken divested these units as a result of a strategic refocusing following the declining performance in the Handelsbanken Group during the years leading up to the divestment decision. Interestingly, however, our findings contrast most established theories on divestments in the sense that the Danish and Finnish units per se were not necessarily performing badly in purely financial terms. Relative to the group, the units' cost-to-income ratios were indeed higher than in Sweden and Norway, but Handelsbanken Denmark and Finland were nonetheless performing rather well compared to peers across several metrics, including cost-to-income ratio, profit margin, and loan loss ratio. Although the net interest margin for both units was significantly lower compared to peers, the return on allocated capital was superior to peers' return on equity. A similar pattern was also viewable across the remainder of Handelsbanken's home markets; most units performed well on some metrics whereas some were inferior to their peer group. Additionally, the Netherlands and the United Kingdom displayed a cost-to-income ratio that was not only higher than peers but also the highest across the Handelsbanken Group. Thus, it appears as if the decision to divest these units was not purely a result of backwards-looking metrics, but rather a qualitative assessment of these markets' future potential and their suitability with Handelsbanken's strategy.

This is also supported by the neutral effect from Handelsbanken's deal with Jyske Bank A/S. The deal itself did improve Handelsbanken's financial situation somewhat, but they did not make any net profit from selling the unit. This strengthens the statement by Handelsbanken's Chief Financial Officer, Carl Cederschiöld, that the sale was part of a strategic refocusing and that the focus was therefore not on making a significant profit from selling the unit.

Even though some of our findings may be applicable to other banks as well, it is important to note that the timing of Handelsbanken's decision to divest these units now could be explained by the fact that they were at a strategic crossroad. In the Handelsbanken case, they could invest more in their Danish and Finnish operations to achieve critical mass, or they could divest their two units and refocus on their core. This dilemma is nonetheless similar to other banks that have recently made divestments in the United States, including BNP Paribas, Spanish BBVA and Japanese MUFG. This is due to the US banking market becoming more consolidated, leaving these actors with the choice to either increase investments or divest parts of their operations. In fact, BNP Chief Executive Jean-Laurent Bonnafé commented on their sale of Bank of the West as "if we hadn't divested, we would have had to buy an equivalent asset". Instead, many banks are either selling or shrinking their US operations to refocus on markets closer to home (Franklin, 2022).

Another explanation as to why Handelsbanken chose to divest instead of invest, could be their relatively weak track record in growth through acquisitions. The Bank has only conducted a few acquisitions throughout its history, including two Danish banks in 2001 and 2008, asset manager Heartwood in 2013 and Optimix in the Netherlands in 2016. Since Handelsbanken would likely need to conduct M&A activity to grow in Denmark and Finland, this may explain the rationale to instead divest and refocus on their core markets and core activities.

To summarize, whilst Handelsbanken's decision to divest these two units was indeed motivated by external factors including local market conditions and regulation, firm-specific factors played a part. The Bank was amid a strategic refocusing, where they were narrowing down its operations from being an international universal bank to a more focused bank, which may explain the timing of the divestments. Handelsbanken was at a crossroad where they had to choose to either increase investments to achieve a critical mass and grow profitably in these markets or divest the units. It is, however, noteworthy that other banks seem to have faced similar dilemmas in terms of either divesting or investing as part of their growth strategies, something which may speak to the Handelsbanken case being part of a larger trend in the global banking market.

6. Conclusion

6.1. Concluding Remarks

Our thesis examines Handelsbanken's divestments of their Danish and Finnish operations and aims to describe what the underlying factors for the decision were, as well as how the case can inform the debate on the optimal geographical scope of European banking.

Our findings show that Handelsbanken's choice to divest their Danish and Finnish units was both a result of external and firm-specific factors. On the one hand, the decision was impacted by an increased regulatory burden, which increased the Bank's overhead costs in each market and forced them to achieve a certain scale to be profitable. Furthermore, local market conditions in Denmark and Finland had an adverse impact on Handelsbanken's operations as a foreign bank. On the other hand, Handelsbanken was making a strategic refocusing on their core markets and core operations, in which the divestment served as an important constituent to narrow down their organization. Factors such as Handelsbanken's outstanding IT and digitalization investments, together with the Bank having become less profitable and cost-efficient in the past years, called for a change. Nonetheless, as evident from, for instance, the Nordea case, regulation results in banks having to reorganize their business models to remain profitable. Thus, if regulation of European banks targets banks of similar size in the same way, one can reasonably assume that other European banks may soon face a similar fate to Handelsbanken in having to focus their organization on their core markets.

Our findings also confirm previous literature by suggesting that exogenous borders may well be present and significant even in jurisdictions with close geographical, political, and cultural proximity to the home market. We also highlight the delicate issue of firms' divestment strategies, where a firm may not always divest the poorest performing units or sell the divested operations to a profit. Rather, it appears as if Handelsbanken simply chose to divest the two units of least strategic importance to the Group, to free capital for future expansion in the remaining units.

6.2. Limitations and Suggestions for Future Research

The aim of our thesis was to contribute with insights on a traditional commercial bank divesting two of its home markets and discuss whether this could inform the ongoing debate on the optimal geographical scope of European banks. Even though the case study format allows for in-depth insight into the case in question and captures the qualitative aspects of the case well, the case study methodology comes with limitations. For instance, the ability to make any generalizations based on one case only are limited. Thus, a suggestion for future research would be to conduct similar case studies on both other Nordic banks as well as other European banks, to examine whether the factors for the divestments found in our case are indeed applicable to other banks as well.

Additionally, our case study was conducted in a rather sensitive time period for Handelsbanken. Whilst the Bank had communicated the divestments and found a buyer for the Danish unit, the deal itself had not been closed when many of the interviews were conducted and was still awaiting regulatory approval. Furthermore, Handelsbanken has not yet communicated that they have found a buyer for the Finnish unit. This has had an impact on the scope of the data collection and areas researched, where some information has been excluded due to confidentiality purposes and may thus have had an impact on our result.

As a final note, our case shows that Handelsbanken's decision to divest these two units was not merely a result of deteriorating financial performance but rather an evaluation of the future potential for these markets. Handelsbanken's management pointed out that the decision to divest was spurred by increased regulation and IT investments in the Handelsbanken Group in general and these two markets in specific. These more qualitative aspects are in general harder to measure; although these aspects have had an impact on Handelsbanken's operations, the scope of the impact is not entirely measurable. Furthermore, these trends in the bank market are complex and it is difficult to examine if and how these variables are co-dependent on each other. Although the case study methodology aims to capture exactly these more qualitative aspects that cannot be quantitatively measured, the area needs more research to find any causal relationship between, for instance, regulation and its impact on a bank's strategy.

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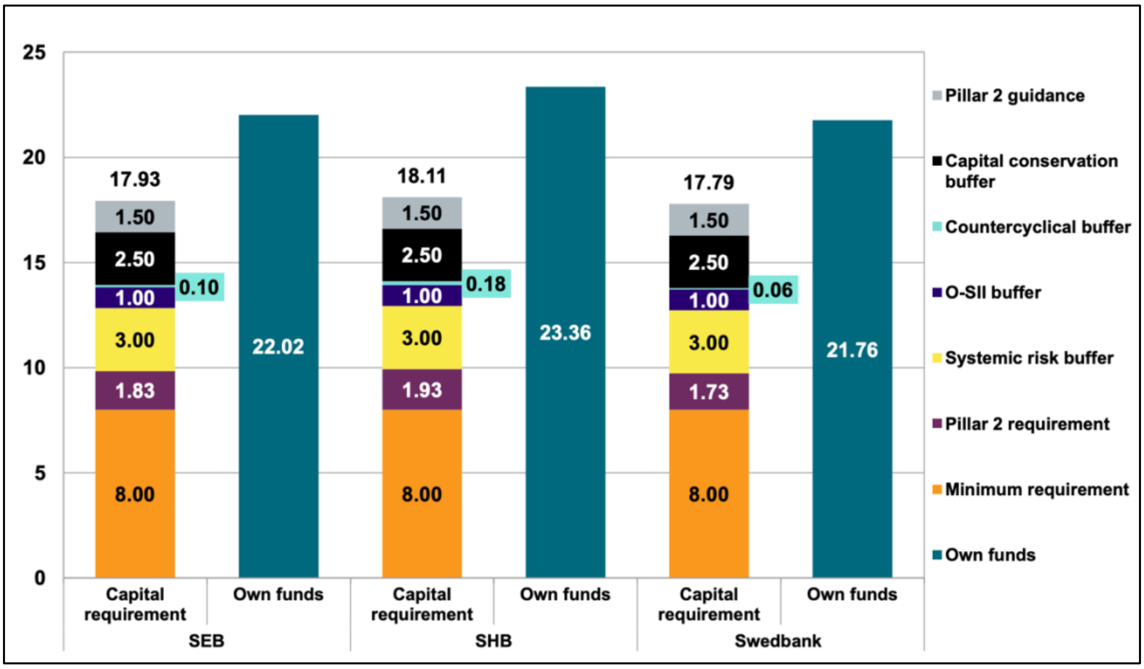
8. Appendix

8.1. Appendix 1: Capital Requirements, Three Major Banks

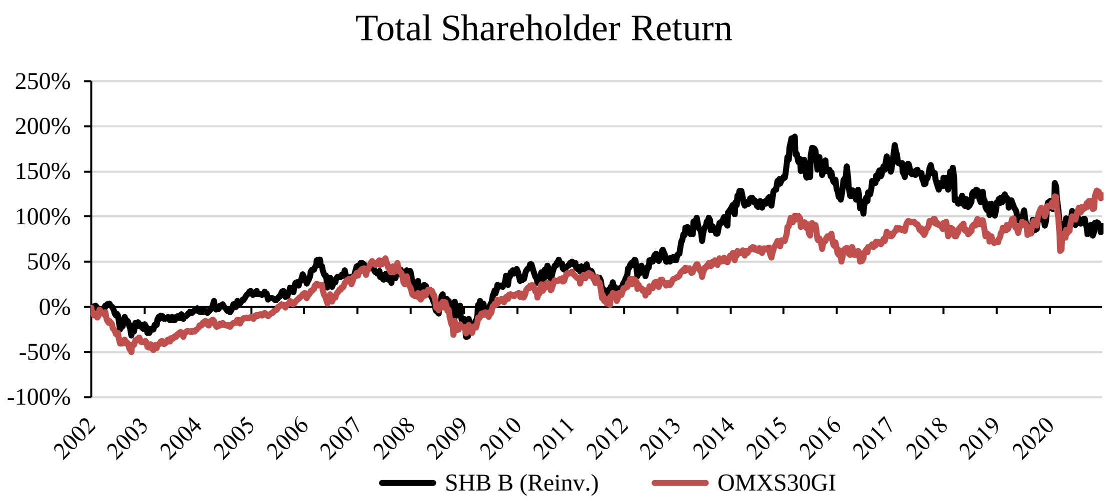


Capital requirements for Sweden's three largest banks as a percent of risk-weighted assets (RWA), as of Q2 2022. *Source: Finansinspektionen (2022)*

8.2. Appendix 2: Interview List

INTERVIEWEE	TITLE	DATE	LENGTH	MODE	PREVIOUS POSITIONS AT SHB
Per Beckman	Executive Vice President and responsible for the divestment of the Bank's operations in Denmark and Finland	September 23, 2022 and October 6, 2022	60 min x 2	In-person	Head of Group Credit, Chief Executive of Stadshypotek AB, Head of Capital Markets, Head of the Region North Sweden
Carl Cederschiöld	Chief Financial Officer and Executive Vice President	September 28, 2022	45 min	Online	Head of Asset Management, Chief Executive Officer Handelsbanken Asset Management, Head of Sales, Securities & FICC, Head of Business Development, Head of Derivative Solutions, Head of Opetions Trading
Martin Noréus	Chief Strategy Officer	October 10, 2022	60 min	In-person	Chief Compliance Officer at Handelsbanken. Prior to that, deputy director general at Finansinspektionen (Swedish Financial Conduct Authority)
Lars Moesgaard	Chief Executive Officer, Denmark	October 10, 2022	30 min	Online	Senior Vice President (Denmark) and Branch Manager at Copenhagen City Branch
Hanne Katrama	Chief Executive Officer, Finland	October 19, 2022	30 min	Online	Regional Manager Finland and Head of Credit Finland
Peter Grabe	Head of Investor Relations	October 24, 2022	60 min	In-person	Deputy Head Investor Relations, Investor Relations Officer, Equity Analyst and Credit Analyst
Lars Kenneth Dahlqvist	Investor Relations Officer	October 24, 2022	60 min	In-person	No previous positions at Handelsbanken
Anonymous	*Equity Research Analyst, Jyske Coverage*	September 21, 2022	45 min	Online	N/A
Anonymous	*Equity Research Analyst, Jyske Coverage*	September 23, 2022	60 min	Online	N/A
Anonymous	*Equity Research Analyst, SHB Coverage*	October 3, 2022	60 min	In-person	N/A

8.3. Appendix 3: Total Shareholder Return



Source: Factset

8.4. Appendix 4: Detailed Calculations for Peer Comparison

Net interest margin: The net interest income in relation to average interest-earning assets, approximated as average lending to the public for the last four quarters.

Cost-to-income ratio (C/I-ratio): Total expenses in relation to total income. For Handelsbanken's segment reporting, profit allocation is included in total income.

Profit margin (incl. loan losses): Pre-tax profit in relation to total income. For Handelsbanken's segment reporting, pre-tax profit is approximated as profit after profit allocation.

Credit loss ratio pursuant to IFRS 9: Credit losses on loans to the public in relation to loans to the public at the beginning of the year.

Adjusted Return on Equity (Adj. ROE): The year's profit in relation to average equity for the last four quarters, adjusted for value changes in financial assets available for sale, derivatives in cash flow hedges, revaluation effects from defined benefit pension plans, and a weighted average of new share issues, dividends, and repurchases of own shares.

Return on Allocated Capital (ROAC): This measurement is reported for each geographical segment of Handelsbanken, since these operate as branches (except for the UK) and thus do not have their own equity. Calculated as the segment's operating profit after profit allocation, calculated using a tax rate of 22 per cent, in relation to the average capital allocated quarterly during the year.

CET1-ratio: Common equity tier 1 in relation to Risk Exposure Amount (REA).

P/B: The share price at year-end divided by the book value per share.

8.5. Appendix 5: Press Release

Handelsbanken

Press release

Stockholm, 19 October 2021

Handelsbanken to leave Denmark and Finland

Handelsbanken has today made the decision to cease its operations in Denmark and Finland. A process is being initiated to divest these two operations.

- Together, Denmark and Finland account for 10 per cent of the income, 13 per cent of the costs, and 8 per cent of the operating profit within the Group.
- The capital allocated to the operations in Denmark and Finland amounts to a total of approximately SEK 15 billion. The common equity tier 1 capital related to these operations amounts to approximately SEK 12 billion.

For decades, Handelsbanken has been one of the world's most successful banks, with higher profitability, more satisfied customers and more stable finances than the sector as a whole. The key to this success lies in the Bank's ability to constantly change in step with our customers' expectations. Handelsbanken's aspiration to constantly become a little bit better at meeting its customers' demands has been a driving factor in its development since it first opened its doors 150 years ago.

The Bank's main markets are in Sweden and Norway, as well as in the UK, where there is an independent subsidiary bank. Together, these markets account for 91 per cent of profits. In these markets, the Bank's ambition has been to be a leading operator in our core areas: financing and asset management.

In recent years, the Swedish operations have been strengthened by a transformation, through which the Bank has become better able to meet its customers' expectations, as regards digital services, online meetings and 24/7 service, and meaning that mortgage loans can be granted, and expert advice provided, across several channels. The Bank has a strong local presence and is, by a wide margin, the Bank with the most branches in the Swedish market. Over the past year, this has resulted in mortgage volumes increasing by 5%, the managed fund volume increasing by 27%, and income increasing by just over 5%. Handelsbanken is today the largest lender among corporate banks.

The Norwegian operations have exhibited very strong performance within the financing core business area over the past 15 years, particularly on the corporate side. As in Sweden, this development is founded on high levels of customer satisfaction and good cost efficiency.

In the UK, Handelsbanken has invested in the formation of an independent subsidiary bank, with a unique offering on a market with considerable potential – not least within Private Banking, where the Bank has been named Private Bank of the Year for several consecutive years. The Bank has also a strong position with further potential within corporate financing.

In Denmark and Finland, just as in the other markets, our banking operations are characterised by customers with stable cash flows, good credit quality and high customer satisfaction. Despite a lasting presence in these markets, the Bank's market position remains small, and the Bank sees little opportunity to scale up its offering without significant investment.

8.6. Appendix 6: Bank Valuation

In contrast to other firms, where cash flow serves as an integral part of the valuation and discounted cash flow analysis (DCF) is commonly used, one cannot separate a bank's operating and financing activities in a cash flow statement analysis. This is because the cash flow activities are highly discretionary, dependent on the Bank management's choice to liquidate its positions. Instead, bank valuation is commonly conducted by practitioners in a multitude of equity-based methods, i.e., the Dividend Discount Model (DDM), Gordon Growth Model (GGM), and the Multiples and Regression approach. What is commonly used by practitioners, however, is a variation of the Gordon growth formula called the "Excess Return Model" or "Modified GGM Formula", in which the price-to-book multiple of equity is a function of long-term sustainable Return on Equity (ROE), and long-term sustainable growth rate (g), discounted with the equity (r_E).

$$\frac{\mathrm{P}_0}{B} = \frac{\mathrm{ROE} - \mathrm{g}}{r_E - g}$$

Since bank activities and capital-structure decisions are highly regulated, there is, theoretically, a small variation in capital structure between banks. Since growth assumptions are linked to reinvestment ability, regulatory changes affecting capital available for investments carry a significant effect on the equity value. Also, since banks rely on mark-to-market accounting, most assets and liabilities are carried at fair market value rather than historical cost. This yields a high "fair" reflection of the book value of equity.

Source: Damodaran, 2009