Listi yfir dótturfélög og útibú íslenskra banka erlendis

Eftirfarandi upplýsingar eru teknar saman fyrir efnahags- og viðskiptanefnd Alþingis, sbr. beiðni iðnaðar- og viðskiptaráðuneytisins frá 18. nóvember sl.

Íslandsbanki hf.
Erlend dótturfélög bankans eru eftirfarandi:
R. Raphael & Sons PLC, Bretlandi
Íslandsbanki Asseet Management S.A., Lúxemborg
ABF Investment Ltd., Mön (eignarhaldsfélag)

Landsbankinn hf.
Erlend dótturfélög bankans eru eftirfarandi:
Heritable Bank, Bretlandi
Landsbanki Capital International Ltd., Guernsey (rekstrarfélag verðbréfasjóða)
Landsbanki PCC Ltd., Guernsey (verðbréfasjóður)

Búnaðarbankinn hf.
Erlend dótturfélög bankans eru eftirfarandi:
Bunadarbanki International S.A. Lxembourg
BI Management Company S.A. Luxembourg

Þá rekur Búnaðarbankinn útibú í Lúxemborg.

Kaupþing banki hf.
Erlend dótturfélög bankans eru eftirfarandi:
Sofi Financial Services Group, Finnlandi
Kaupthing Bank Luxembourg S.A., Lúxemborg
Alpha Venture Capital Fund Management S.A., Lúxemborg
Kaupthing Management Company S.A., Lúxemborg
Kaupthing New York Inc., Bankaríkjunum
Kaupthing Bank A/S, Danmörku,
Kaupthing Services S.A., Sviss
Kaupthing Føroyar Virdisbrævameklarafelag P/F, Færeyjum
Handsal Asset Management S.A.R.L., Sviss

European Savings Banks

Coming of Age ?

CREDITANSTALT
CARIPLO
HALIFAX
LA CAIXA
WESTDEUTSCHE LANDESBANK GIROZENTRALE
SPAREBANKEN NOR
DEUTSCHER SPARKASSEN-UND GIROVERBANK (DSGV)
CAISSE NATIONALE D'EP

EXPLORING THE ROLE OF SAVINGS BANKS IN EUROPEAN FINANCIAL SERVICES

LAFFERTY

2 Savings Banks in the Deregulatory European Environment

Introduction

This chapter highlights the main problems facing the European savings banks sectors and identifies three important strategic responses: solidarity, consolidation and co-operation. Other strategic issues relating to raising capital, the role of mutuality and privatisation are also examined.

Savings Banks and European Deregulation

As early as 1989 four main problems facing European savings banks were identified by Revell[1]:

1. How to raise additional capital in order to meet stricter capital adequacy rules and fund new expansion;

2. How to assess the most efficient size for individual savings banks;

3. How the savings banks should react to new powers (in certain countries such as Spain, and later in Italy and France) that enabled them to operate outside of their autonomous region and previously-segmented markets; and

4. How to meet increasing competition from domestic and foreign institutions.

Underlying these problems is a more fundamental one: how might those savings banks organised as mutual non-profit institutions retain their distinctive operational and economic characteristics and operate successfully in an increasingly competitive financial market? A related and fundamental question is whether the present mutuality of savings banks can survive in the targeted free-market framework of EMU. If 'mutuality' is taken to include all those savings banks that are organised as 'non-plcs' (public limited companies) and 'non-state (government) dominated' in their ownership, then the broader question addressed in this study is whether any form (of organisational model) of 'non-plc' can survive and prosper in the "New" Europe. Many European savings banks are not, of course, mutual in the strictest sense, but are 'non-plcs' in this broader sense. Such questions are increasingly being posed by bankers, policy-makers and economists throughout Europe.

Revell cautioned that these types of question regarding savings banks are inevitably concerned with matters that 'border on the political and social'. As a result, they cannot be addressed without involving some value judgements.

1 Revell, J, *The Future of Savings Banks: A Study of Spain and the Rest of Europe*, Institute of European Finance, Research Monographs in Banking and Finance No 8, University of Wales, Institute of European Finance, Bangor, UK, 1989.

Revell expressed the dichotomy between the traditional savings banks philosophy and the free market view:

> "The conflict is between the free-market philosophy, with its single goal of profit maximisation, and the philosophy of the savings banks in all countries, which attaches value to the economic welfare of a particular locality, to social works for the benefit of the inhabitants of that locality, and to co-operation rather than conflict and competition between individual savings banks."

Revell came down firmly on the side of the savings banks philosophy. Of course, not all savings banks are non-profit maximising concerns; in some countries, they seek to maximise their profits. Many savings banks today, however, still have the same objectives as the earliest savings banks founded almost two centuries ago:

- To foster savings among the general population;
- To develop the economy of the locality; and
- To carry out social works in that locality.

Revell (1989) identified several features of institutions that focused primarily on the above objectives, and distinguished them from those institutions that had profit maximisation as their sole or main goal:

- In most cases they are relatively small;
- Their main business has tended to be in the retail banking sector, but the large individual banks and central savings banks have moved into corporate and international banking over the past 20 years;
- Because of their main customer base, they have tended to be relatively risk averse;
- Up to the present [1999], they have been immune to hostile takeover; and
- Probably because of low competition within the same local market, they have co-operated nationally and internationally and have a sense of belonging to the savings bank movement.

These characteristics are not unique to savings banks, but apply also (wholly or partly) to other mutual financial institutions and sometimes to those under public ownership. Some of these characteristics also apply to several other different types of bank. An important feature of many savings banks is that they operate in districts not covered by larger banks; under these conditions their lending is highly dependent on local knowledge. Although many of the features still characterise the European savings banks sector since the late-1980s, there have been major changes in the external environment which is shaping the strategies of savings banks.

A consequence is that the separate identity of Europe's savings banks has been markedly eroded. Symptomatic of these changes was the withdrawal in May 1991 of the UK TSB from the European Savings Banks Group and the International Savings Banks Institute (ISBI). This departure was seen as "... symptomatic of the danger that European and international savings banks are losing their identity, if not their way".[2] (TSB subsequently rejoined the ESBG.) Savings banks have faced a common threat with the growth of international competition in the "New" Europe. Blanden points out:

> "The roots of the savings banks in encouraging thrift in local communities, and in many cases helping to fund governments, provided a justification for working together. Rather than taking on cross-border mergers, the talk has been of setting up co-operative ventures. But just as in commercial banking, there is little evidence that this is working. One reason is the huge differences in structure between member countries."

The role of savings banks in their local market varies greatly from country to country. TSB (before its public floatation), for example, represented the UK savings bank sector and was ranked sixth in size compared with the big UK banks. In countries like Germany, Norway and Spain, however, the savings banks as a group are much more important. In countries such as Germany, Denmark and Greece the savings banks have traditionally focused on individuals. In other countries (Belgium and Italy) the savings banks have invested a large proportion of their assets in public-sector securities, and the respective strategic emphasis of the savings banks has been more 'government oriented'.

Blanden said two important developments had affected the strategies of the savings banks. One is that the opening-up of Eastern Europe has distracted the attention of the international associations of savings banks and the German savings banks. The other is the SMP and stricter capital adequacy rules that have emphasised the need for financial and competitive strength in the "New" Europe. Smaller institutions operating independently are seen as being less viable in this environment.

Since the early-1990s European savings banks have faced several challenges. Although they feel their historical roots set them apart from other financial institutions, the reality is different for savings banks in many countries. In several European countries they have developed into (or aspire to) full-service universal banks competing directly (by themselves or through their central organisations) with the established, mainstream commercial banks. Despite these differences, in the field of European banking deregulation, the European savings banks consistently refer to their common roots – calling for the protection of the interests of small and medium-sized savings banks.

In 1997 the ESBG (European Savings Banks Group) told the European Commission, during the debate on simpler legislation for the internal market (SLIM), that European banking law was mainly derived from rules made by the Basle Committee which reflected the practical supervisory needs of international banks (global players). However, as the majority of banks in Europe are medium or even small-sized credit institutions, it should be recognised that the Basle rules cannot be applied unconditionally to all European banks. In order to maintain banking pluralism in the internal market, the savings banks consider that, for certain issues, it is necessary to differentiate between large and small banks. A special framework, such as allowances or non-application of rules for certain medium and small-size credit institutions, should be possible for those institutions that are strictly in line with the principle of fair and equal competition within the internal market.

2 Blanden, M, "Wobbly Vision", *The Banker*, September 1991.

Difficulties in their domestic markets have been another source of pressure for European savings banks (and their commercial bank competitors). This has been the case throughout much of Scandinavia. The problems of Första Sparbanken in Sweden and Skopbank in Finland during the early-1990s are indicative of such problem. Yet another source of pressure is the changing face of Europe: not only the opening-up of central and eastern Europe, but also the enlargement of the EU to include some EFTA and other new countries. *The Banker*[3] quotes former ESBG general secretary Klaus Meyer-Horn, commenting early in 1992:

> "Savings banks, even the biggest among them, will be unable to keep up with the pace. Only 29 savings banks in 11 countries manage more than ECU5 billion ($7 billion) – all 29 of them together do not even equate to ECU250 billion [assets]."

Prior to 1992, European savings banks came up with three possible solutions: first, mergers within their own countries; second, co-operation between savings banks in different countries; and third, joining larger diversified groups. In its survey, *The Banker* concluded that "...staying with historical links could be more of a hindrance than a help to savings banks". In a later survey, *The Banker* re-emphasised that "historical differences between institutions are ceasing to be significant".

The three key strategic themes for European savings banks appear to be solidarity, consolidation and greater co-operation. Solidarity and intensified co-operation among savings banks have been reflected at one level in the setting-up (June 1994) of a joint office in Brussels of the WSBI (World Savings Banks Institute) and the ESBG. In 1994 the International Savings Banks Institute (ISBI) and ESBG finalised a restructuring process that provided for a new joint organisation of their advisory committees. Subsequently, the activities of the Geneva-based ISBI were transferred to the WSBI in Brussels. These restructuring and consolidation moves towards greater co-operation among the savings banks' representative associations, together with their Brussels base, gave them enhanced lobbying power. According to *European Banker*[4]:

> "The new structure has led to a redefining of European savings banks strategy. Further emphasis will be placed on creating practical business links through mutual agreements between banks, intensifying relations with small and medium-sized enterprises through which savings banks already hold a large market share and developing the potential of the savings banks' automated teller network, EUFISERV."

It is suggested that by increasing co-operation (rather than the actual branch networks) savings banks will be able to preserve their traditional regional and local identity. In March 1990 11 savings banks from 12 EU countries, together with four savings banks from associated countries, concluded a co-operation charter. Companies were established the shareholders of which were the main savings banks' networks in Europe. EUFISERV's objective is the development of automated currency services throughout Europe; EUFIGEST specialises in the management of ECU-denominated undertakings for collective investments in transferable securities (UCITS); and EUROSOFAC supplies services to savings banks' SME resources.

3 "Identity Crisis", *The Banker*, September 1992.
4 "With Solidarity the Future Looks Good", *European Banker*, November 1994.

Despite market pressures to downgrade their traditional social roles, savings banks throughout Europe have sought to build strategies that reflect their roots and traditional market base. This suggests the need for them to adopt a selective approach and choose activities that best match their particular situations. Some strategists emphasise the importance of enhancing customer service rather than seeking new activities. One proposal along these lines is practising a consolidation strategy "...strengthening their positions by mergers while preserving their personality and image...".[5] Many experts believe this consolidation strategy should be combined with a pan-European alliance strategy in order to ensure the long-term survival of European savings banks.

It has been argued that the continued social role of savings banks becomes even more important in a deregulating financial system. Le Ray[6] emphasised the dangers to society of particular social strata being excluded from the means of participating in economic life, and stressed the wider social and (localised) economic development role of savings banks. Sustaining this traditional social role in the future and preservation of the mutuality ethos are, of course, two of the major issues for savings banks in the "New" Europe.

In this context, one of the primary goals of the savings banks is to further social cohesion in the areas in which they operate. Maintaining close ties with the local economies and societies in which they are based constitutes an essential element of the savings banks' approach to social responsibility. Therefore, modern savings banks try to constitute a link between competitiveness and economic efficiency on the one hand, and subsidiarity and social solidarity on the other. By virtue of their natural customer proximity, their strength and the outstanding level of customer confidence that they enjoy, the savings banks consider themselves to be well positioned to meet and survive ever-tougher competition.

Related Strategic Issues

The European savings banks sector faces three main issues: the capital challenge; mutuality; and the role of the state.

The Capital Challenge

One of the key strategic drivers for EU savings banks is the 'capital challenge', ie the need to widen sources and increase the flow of capital into the organisation. This challenge is exacerbated as intensifying competition puts more pressure on profits and the respective rate of internal capital generation in European savings banks. As we have seen, increasing emphasis on capital adequacy supervision and external market tests of efficiency have enhanced the importance of internal capital allocation in savings banks. At the same time, the competitive pressures in some countries and for some banks (particularly the smaller ones) to secure the benefits of greater size are also bound up with the question of capital – size and capital strength go hand in hand.

Deregulation and intensifying competition are perhaps the two most fundamental strategic drivers shaping the growing pressures on savings banks to seek better use of their existing capital and secure new sources of external capital funding. Many European savings banks appear under-capitalised compared

5 "Savings Banks Survey: A Pan-European Challenge", *European Banker*, March 1993.
6 Le Ray, A. "Savings Banks Span the Global Economy", *Perspectives*, 4, October 15 1995.

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with their commercial (plc) banking competitors. This may constrain their ability, for example, to invest in new technologies and expand their products and markets. It also restricts (through, for example, capital adequacy regulation) their ability to move into higher-risk (and, of course, higher-return) business. Revell suggests that capital requirements "have become the greatest constraint on growth".

In the absence of plc status and new (allowable) capital instruments issued by savings banks, a transfer to reserves (internal capital generation) is the main source of savings banks' capital. Revell used a series of simple simulations to show the inter-relationships between annual surplus, annual increase in the reserve (capital) ratio, the reserve ratio at the beginning of the year and the rate of growth of total assets. In particular, he focused on the effect on the annual surplus of moving from a current capital ratio to the required ratio (of 8 percent) over a five-year period. These simulations show, for example, that moving (in equal annual hikes of 0.2 percent) from a reserve ratio of 7 percent to 8 percent, over a five-year period with an annual 14 percent growth of total assets, means that the rate of annual surplus has to increase mechanically from 1.06 percent to 1.16 percent. Revell believed many European savings banks would be unable to meet such target.

In this scenario, savings banks have a number of (not necessarily mutually exclusive) options:

- Convert to plc status;
- Be allowed to issue new types of capital instruments;
- Change their asset composition;
- Sell existing assets; or
- Agency business.

The following analysis will focus on the major strategies that savings banks are pursuing.

During recent years various forms of new capital instrument have become available to European savings banks. Subordinated debt and participation capital, including permanent interest-bearing shares (PIBS), are two of the most prominent forms of new capital instrument; participation capital (or hybrid capital) is the newer type of instrument for savings banks. *Table 2.1* lists some of the main types of European participation capital available in the late-1980s. Despite their different names, these instruments are broadly similar in economic terms. Nevertheless, each issue needs to be examined closely to ascertain the precise legal and related characteristics.

Participation capital for savings banks is similar to preference capital in corporate capital structures. In this sense, participation capital is a hybrid instrument, bearing some of the characteristics of debt and equity. Participation capital becomes more 'equity-like' when it carries voting rights. The latter makes participation capital more attractive to holders and thereby reduces the respective servicing costs. Various voting rights may attach to the many types of participation capital that have been issued. In summary, smaller savings banks are more restricted, as are not well known, in their ability to use any of these new capital instruments.

Participation Capital of European Savings Banks

Country	*Title*	*Voting Rights*
Austria	Genußschein	No
Finland	kantarahasto osake	Yes
Germany	Genußschein	No
Italy	quota partecipativa	Yes
Norway	grunnfondsbevis	Yes
Spain	cuota participativa	No
Sweden	garantifondsbevis	No

Source: Revell (1989)

Table 2.1

The issues relating to the use of various capital instruments are considered as part of a set of suggested future strategic policies for the Spanish savings banks. It was argued that a suitable long-term solution, which would probably suit most of the Spanish savings banks within their present organisational model, would be for the banks to promote some capital instruments to improve their capital position, and simultaneously introduce some 'market-value' indicators into the savings banks sector. Compared to other European countries, Spanish savings banks have made no use of the participation capital and less-extensive use of subordinated debt.

In Spain participation capital has not been attractive to potential investors or to savings banks, because it does not entail voting rights and was not adequately promoted. However, if participation capital incorporated voting rights and were to be promoted in the financial markets (for example, with full listing), participation capital (or any other similar instrument) would be far more attractive, and savings banks could make issues to improve their capital position. As a consequence Carbo[7] suggested that legislation should be modified to allow holders of participation capital to have stronger voting rights.

With full official listing of these instruments, some 'market-value' indicators would be introduced into the Spanish savings banks sector. This would be a small but necessary step towards more 'market-like' organisational and legal alternatives that might be introduced in Spain in the future. The introduction of these market-value indicators is also likely to induce consolidation within the sector, as small savings banks would be more restricted in the use of such instruments because they would be less well known to the market.

With expectations of falling margins and higher profitability pressures, Spanish, as well as other European, savings banks are likely to make more extensive use of such hybrid capital instruments. Both participation capital and subordinated debt may play a major role in improving capital positions without major

7 Carbo, S, EPM Gardener, P Molyneux and J Williams, *The Future of Savings Banks in the Single Financial Market of the EU*, Report to FIES; Spain, Bangor: Institute of European Finance, 1996.

changes of legal status of savings banks or without alterations to their asset structures.

Changing asset composition of savings banks is another method of increasing economic capital. Altering portfolio compositions to increase the relative proportions of lower risk-weighted (for capital adequacy purposes) assets, for example, enhances a bank's economic (real) capital. The cost of this move is, of course, invariably reduced profit potential. A similar type of strategy is to sell assets and shrink the balance sheet. This latter strategy may involve securitisation. In a system that facilitates asset-backed securitisation (ABS) a financial intermediary, such as a savings bank, could become an originating and limited servicing unit, a conduit for the initiation of open-market paper (asset-backed securities).

Agency business is the final option that was mentioned above. Banks may encourage corporate customers to use capital markets (securitisation) in preference to bank loans. The banks in this scenario receive (off-balance sheet) fees and commissions. Other forms of agency links may involve savings banks forming alliances with commercial banks and other types of financial service firm, for example, to deliver particular kinds of financial services (such as chequing facilities).

Yet another 'agency solution' (which also bears directly on attempts by savings banks to secure the competitive advantages of larger size) uses a central savings banks organisation to raise funds and develop other services for which economies of scale, scope and specialisation economies might exist. In economic terms, this type of 'agency model' may be viewed as a form of 'internal market solution' for savings banks.

Mutuality

Another way of improving the capital position of savings banks is to convert to plc status. Revell rejected this solution because he felt it "...to be entirely destructive of the characteristics of savings banks". However, he said there were types of conversion to company form that did not necessarily destroy the nature of savings banks. He referred to these latter types of conversion as 'conversion by separation'. Under this scheme a company is established to run the bank, but the foundation or association remains in existence as a holding company. So far, there appear to have been only a limited number of these 'conversions by separation' in Europe.

The advantages of conversion to plc status have been well documented in the literature and among practitioners. The most-important advantage is the large injection of new equity capital from stock exchange floatation. This new equity infusion can also support more (a higher absolute amount of) debt capital. Ordinary (equity) shares are more attractive to investors than the present forms of capital available to savings banks. This lowers their relative cost, which savings banks have to balance against their potentially reduced surpluses (or lower internal capital generation rates) after plc conversion.

Another potential advantage of a plc conversion, with all its attendant publicity, is that is enables a savings bank to re-position itself in the market and, possibly, upgrade or at least re-define its 'market image'. In a market-led economy, these latter strategic benefits are important; they cannot be ignored and they can have an impact on a bank's cost of capital. Again, a resultant 'cost' to savings banks is the increasing attention they must pay to enhancing shareholder value and meeting external market tests of their efficiency. Because savings banks increasingly compete in the open market, they are subject to the discipline of external market tests. It could be argued that such tests (with their relative emphasis on short-term performance) might compromise the traditional longer-term view that savings banks have adopted. As mentioned earlier, a more fundamental cost to society is that some of the lower social segments may become disenfranchised if all savings banks convert and become subject to the free market. This leads to the fundamental issue of mutuality.

As previously mentioned, 'mutuality' is generally taken to refer to savings banks that are organised as 'non-plcs' and are 'non-state (government) dominated' in their ownership. According to Revell, strictly speaking, the term 'mutual' does not apply to savings banks in any country;[8] Revell also cautioned that 'non-profit' was also misleading when applied to savings banks. Mutuality is, therefore, not a precise concept. With these important caveats in mind, the general debate on mutuality is relevant to savings banks as it is fundamentally a debate about whether savings (and other) banks not organised as plcs should convert.

Revell was strongly opposed to the notion that mutuality was an outdated concept with no economic 'value added' in a deregulating, free enterprise economy. He refers to an 'ideological battle' being waged by extreme free marketeers against mutualism. Having outlined earlier the attractions of converting to plc status, the advantages of retaining mutuality may be listed:

- Customers may get a better service because staff recognise customers as their owners;
- Savings banks are primarily committed (at least in their traditional segments) to serving the banking needs of households and small businesses of their locality;
- Mutual financial institutions provide financial services to social strata levels that might otherwise be largely disenfranchised from financial services;
- Savings banks have a responsibility to develop the economy and social services of their locality;
- Consumer choice may be increased as savings banks provide services that often differ in important respects from those of private banks;
- Customers may receive better value as mutual institutions are not required to pay dividends;
- Savings banks are able to take a longer-term view without being dominated by (external investors') short-term performance;
- As many savings banks are comparatively small independent institutions, they can offer greater flexibility, speed and the 'personal touch' to customers; and

8 Strictly speaking, the term 'mutual' implies that the institution has been founded by a group of individuals for their own benefit and that they continue their own affairs. Savings banks were generally founded by philanthropic people for the benefit of others. (Revell, *op cit*, p49).

- Savings banks are traditionally risk averse and are, therefore, perceived to be relatively safe.

In strategic marketing, these attractions may be summarised as: greater customer focus and orientation. The challenge is to convert these attractions (assuming that they exist) into marketable 'product attributes' and price them accordingly. Governments may also have to be persuaded that increased economic efficiency – a fundamental aim of deregulation – does not imply any need for selective areas of protection in order to safeguard certain key sectors and related economic objectives (such as ensuring that all social strata have access to financial services and learn how to deploy them to economic advantage).

However, the special attributes listed above have been questioned; some of the values they represent are argued to be abstract and largely irrelevant in a world where 'capital is king'. A recent UK CSFI (Centre for the Study of Financial Innovation) round-table discussion asked whether these values were robust enough to withstand market forces in the absence of any special government protection for mutuality. These involved in the discussion found it "...hard to come up with a positive answer". They said, for example, that the UK building society movement was likely to survive in its traditional form only at the smaller end of the size spectrum. Such societies probably occupy local market niches, competition from banks is weaker, and they are less vulnerable to takeover offers.

The mutuality debate is complex and wide-ranging. Our concern is less with the ideological debate and more with the strategies that savings banks are adopting and are likely to adopt in the future. In the following chapters we will explore the 'strategic adaptive process' being pursued by savings banks in the new environment. It is, perhaps, apposite and certainly salutary to conclude this section by suggesting that there is significant market opinion in the UK and US, the two most strongly market-orientated financial systems, that the mutuality concept is under great threat.

The Role of the State and Privatisation

The recent embrace of market philosophy by various European governments has brought into question the role of the state. Advocates of market theory emphasise the operation of the price system in efficiently allocating resources: government intervention is thought to distort the price mechanism and lead to inefficiency. European governments have openly sought to make markets more competitive; the completion of the internal market is one such example – the Cecchini report (European Commission, 1998) and Price Waterhouse (1998) report highlighted the consumer surplus gains hypothesised to result from the single market. Financial liberalisation and deregulation have given banks the impetus to enter into new market segments, develop new products and services, and find more-efficient means of funding their operations.

During the 1980s European governments faced heavy fiscal burdens. These were not eased by continuing financial problems resulting from state-ownership of apparently non-efficient assets. Across Europe, past government intervention had brought large proportions of national banking systems under state-control; indeed, some banks were incorporated as state owned concerns. For example, the Italian banking system was largely state-owned, and the French government owned some important banks. The need to free up state finances, together with an adherence to market philosophy, effected a wide-ranging privatisation process that included the sale of a number of state-owned banks.

The transfer of bank ownership from state to private hands had two effects on privatised banks:

1. The concept of profit maximisation for the benefit of shareholders was adopted; ROE emerged as an important performance benchmark; and

2. Banks became subject to the discipline of the market; bank share values are determined by market appraisal, with the possibility that long-term benefits may be sacrificed for short-term gain and/or appeasement of the market.

The adoption of market values changes banks' organisational strategies and goals. Whereas a state-owned bank may, for example, provide favourable loans to industry for social as well as long-term economic objectives, a privatised institution is more likely to consider such activities on the basis of financial returns only. This example signifies the effect of different types of ownership structure. Market theorists would suggest that industry must pay the market rate in order for market clearing to occur; the result could be that industry is denied vital capital, which, via a multiplier process, could undermine economic growth.

It can be argued that market solutions may not be optimal. Market failure can arise for a number of reasons. Instances of market failure tend to have underlying and common causes: property rights, and information and transactions costs. In practice, banking systems are organised as monopolistic (many sellers but each product has some form of differentiation attached) or oligopolistic/imperfect markets (where a small number of firms can affect the terms of trade).

There is at least one logical reason why banking must be considered as a special market: banks provide the credit needed for economic growth and their activities need to be supervised and regulated to ensure that systemic risk is minimised. Supervision and regulation of banks, it can be argued, undermine the concept of the perfect market (as do the existence of deposit insurance, the lender of last resort, and the 'too big to fail' doctrine). Even in competitive conditions banks have shown a tendency to become concentrated via mergers and acquisitions; many studies have been carried out to test the theory that bank concentration leads to collusive practices and abnormal profits; or, alternatively, whether increased concentration can improve efficiency.

Although the role of the state is diminishing in importance across European banking markets, it may be argued that private ownership and apparent increased competitiveness need not necessarily result in a superior solution. Schumpeter suggested that some forms of imperfect competition might in the long term be economically superior to perfect competition.[9] Schumpeter contended that invention and innovation might proceed at a faster rate under imperfect competition and so, in the long term, allow for greater productivity of employed resources. The argument proposed by Schumpeter is not merely a case of conflict between static and dynamic efficiency. At its heart is the notion that the externalities and uncertainties that negate perfect competition may, under alternative organisational market structures such as imperfect competition, be internalised or reduced. The dynamic nature of imperfectly competitive firms is assured in Schumpeter's view by the prospect of the innovation of substitute products: this prospect encourages companies to develop new

9 Schumpeter, J, *Capitalism, Socialism and Democracy*, Harper and Brothers, New York, 1942.

products and improve the quality of existing ones; competition thus incorporates quality rather than price.

It should also be noted that the ownership structure of savings banks is far from homogeneous. Some Italian savings banks are organised as joint stock companies with share capital, whereas Norwegian savings banks are wholly independent. Swedbank of Sweden is a public limited company; most German savings banks are municipally owned (except for a handful of private-owned institutions). The French savings banks are non-profit mutual institutions; whereas the building societies in the UK are a mixture of mutual and public limited companies (plcs). The debate surrounding the privatisation of savings banks is thus applicable to Germany and France; the Italian case is slightly different in that the foundations that control the savings banks are public entities.

A common theme of arguments advocating the privatisation of savings banks concerns certain 'privileges' that savings banks' ownership is perceived to convey. In France, the *caisses d'épargne* (savings banks) are the sole collectors of the relatively-cheap Livret A deposits. German advocates of savings banks' privatisation argue that the *Sparkassen* (savings banks) and the *Landesbanken* act more like private commercial banks, in contradiction to their historic statutes; municipal ownership is thought to provide other advantages, including better ratings. The Italian Dini Directive of November 1994 states that the savings banks foundations are non-profit organisations; furthermore, the foundations must dispose of their controlling interests in banks by 1999. There is considerable debate in Italy concerning the Dini proposals, and a recent (1997) directive, the Ciampi Directive, has been enacted to make the ownership of Italian banks transparent.

The German savings banks sector has been characterised by increased consolidation in recent years; savings banks have attempted to achieve critical mass through merger activity rather than change their ownership structure. Some German savings banks have tried to privatise: Landesgirokasse Stuttgart was unsuccessful in a privatisation procedure and instead merged with Baden-Württembergische Bank. One savings bank that has changed ownership is Landesbank Berlin, which was merged with Berliner Bank and Berliner Hypotheken-und Pfandbriefbank to form Bankgesellschaft Berlin in 1994. Although quoted on the German stock exchange, BankGes is owned by the Lönd of Berlin which stated its intention in late-1995 to reduce its holding to a still-controlling 50 percent plus-one share by 1997. Crucially, there is no political pressure in Germany on savings banks to privatise.

In the UK a vociferous debate has raged over mutualism in the building society sector (see *Chapter 4*). Certain notable and large building societies have opted to change their status and convert to plc. The Abbey National plc became a bank in 1989. In 1997 four building societies – Halifax, Alliance and Leicester, Woolwich, and Northern Rock – converted to plc status. Other building societies, such as the Nationwide, remain strongly committed to the concept of mutuality.

Conclusion

European savings banks share certain characteristics: they are mostly small in size; risk aversion is prevalent; and their main activity is retail banking. A fundamental problem facing the European savings banks industry is how to remain organised along mutual, non-profit lines retaining its distinctive operational and economic characteristics and, at the same time, operate successfully in an increasingly-competitive financial market.

As a response to the problems facing the European savings banks industry during the 1980s, three trends have emerged: solidarity, co-operation and consolidation. The European Savings Banks Group (ESBG) facilitates solidarity and co-operation through the various national savings banks associations and at the European level. Through their shared interests, common goals, and pooled resources the savings banks, via the ESBG, have established initiatives and subsidiary companies that supplement and enhance their existing operations.

Increasing market pressures would appear to be downgrading the savings banks sectors' traditional social and economic roles. The savings banks have responded by building strategies that reflect their roots and traditional market base (which many consider to be a comparative advantage). It might be argued that the European savings banks sectors should seek to develop existing core customer relationships (through an extended provision of suitable products and services), rather than try to grow new initiatives. Perhaps the way forward lies in a strategy of consolidation: ie in the building of strategic alliances (both domestic and pan-European) that would allow savings banks better to service their customer base, and to promote their social role accordingly.

Savings banks face three main strategic issues: capital, mutuality, and the role of the state/privatisation. A key driver of change for the savings banks sectors is the capital requirement and there are various options. Conversion to joint stock company status is one solution to the capital problem. Another approach has been to develop agency business, particularly in response to disintermediation. A major challenge for savings banks is how to convert the many benefits of mutual status into marketable product attributes. Mutuality is also threatened by governments' gradual withdrawal from bank ownership. Privatisation is one outcome of this trend but it remains to be proven that private ownership is superior to alternative forms. In the short to medium term, however, these trends are likely to increase consolidation in the European savings banks industry.

3 Structural Changes in European Savings Banks Sectors

Introduction

The key changes in the industry structure of savings banks sectors are surveyed in this chapter. The analysis examines the period 1984–1997 in order to identify long-term and short-term trends. The first part of the chapter analyses the structural characteristics of the European savings banks industry and charts the changing situation in terms of the numbers of savings banks and the size of their branch networks. The evolving balance-sheet structures of savings banks sectors are then considered; and an analysis of market share follows. The issues of size and concentration within the savings banks sectors are also addressed; followed by details illustrating the savings banks sectors' non-bank lending by customer segment. In this way, because the bulk of savings banks' non-bank lending is made within localities/regions, it is possible to identify the contributions made by the savings banks to economic and social development.

The Number of Savings Banks and the Size of Branch Networks (1984–1997)

The structure of European savings banking has undergone intense scrutiny and reorganisation since national governments embraced the concept of financial deregulation during the 1980s. The advent of the single financial market has given national governments the opportunity to reform aspects of domestic financial systems, bringing them more into line with the prevailing competitive ethos. The capital challenge to savings banks, increasing questions about the longer-term survivability of mutuality, and privatisation are all part of a deregulation-free market ethos that increasingly characterises the "New" Europe.

Structural change has occurred in two main ways: restructuring and natural attrition. In certain countries there has been a complete restructuring of the savings banks sector which, in practice, has organised savings banks around a 'pole', ie a national and/or regional institution that manages the affairs of the savings banks group(s). Reorganisation is facilitated through merger activity.

France provides an example of restricting change. In 1984 there were 465 French savings banks (see *Table 3.1*); by 1990 the number had fallen to 182; the increased concentration reflected measures designed to counteract problems pertaining to capital adequacy. In June 1991 further and more-radical restructuring was undertaken and the savings banks sector was 'reconfigured' around 35 savings banks (31 in mainland France) which acted as regional-based poles of competence. The 1991 reorganisation established the current network of savings banks. At the head of the French savings banks group is CENCEP (Caisse National des Caisses d'Epargne et de Prévoyance), a joint venture between the savings banks (65 percent ownership) and the government-owned institution Caisse des Dépôts et Consignations (CDC, with 35 percent ownership). The three institutions jointly own the CCCEP (Caisse Centrale des Caisses d'Epargne) the central banking institution for the savings banks group.

Numbers of Banks: Savings Banks and Banking System (1984–1997)

Country	1984	1989	1992	1994	1996	1997
Savings Banks						
Austria	131	126	89	75	74	71
Belgium[1]	28	29	28	32	–	–
Denmark	147	128	118	115	109	111
Finland	263	178	39	41	40	40
France	465	212	35	35	34	34
Germany – *Sparkassen*	591	583	542	657	607	598
Germany – *Landesbanken*	12	11	12	13	13	13
Italy	79	75	76	74	72	73
Netherlands	67	54	43	28	26	26
Norway	227	151	134	132	133	133
Portugal	14	10	11	10	10	9
Spain	81	78	54	52	51	51
Sweden	149	109	91	91	91	90
UK – *Savings Banks*[2]	4	4	1	1	1	1
UK – *Building Societies*	190	126	105	96	88	82
Banking System						
Austria	1,257	1,240	1,104	1,053	1,019	995
Belgium	165	157	157	147	141	134
Denmark	231	233	210	202	199	197
Finland	644	552	365	356	352	350
France	358	418	617	607	570	519
Germany	3,025	4,089	4,200	3,872	3,674	3,578
Italy	1,137	1,127	1,073	994	937	935
Netherlands	2,079	1,058	921	744	658	628
Norway	248	179	158	153	152	154
Portugal	14	29	36	45	51	62

Table 3.1

Numbers of Banks: Savings Banks and Banking System (1984–1997)

Country	1984	1989	1992	1994	1996	1997
Spain	369	333	319	316	313	307
Sweden[3]	556	515	119	106	114	120
UK	598	551	518	486	478	466

Footnotes:
1. The Belgium savings banks sector underwent a change in 1993 when two of the major savings banks (CERA and BACOB) became commerical banks. The data reported in this chapter are for the savings banks sector as defined prior to the 1993 changes for the purposes of consistency (except where noted).
2. These data refer to the TSB.
3. The data for 1984 are at 1985; 1989 at 1990; and 1994 at 1995.

Source: Association Belge des Banques (1998, 1996); Banca d'Italia (1998, 1996); Banco de Portugal (1993, 1995–1997); Bank of England (1998); Bank of Finland (1998); Bank of Spain (1998); British Bankers' Association (1995–1997); Banque de France – CECEI (1996, 1990); Banque de France (1998–1999); BIS (1998); Building Societies Association (1990–1997); Deutsche Bundesbank (1997–1998); De Nederlandsche Bank (1990, 1993, 1996–1997); ESBG (1994–1997); EUFI Journal (various); European Central Bank (1999); Finnish Bankers' Association (1995–1997); Nordiska Bankmännaunionen (1997); Norges Bank (1997, 1995, 1993,1990, 1985); OECD (1996, 1994, 1991); Oesterreichische Nationalbank (1990, 1998–1999); Sveriges Riksbank (1998)

Table 3.1 cont'd

A similar situation occurred in Finland in 1992. After a period of intense distress for the savings banks sector, 41 independent savings banks (out of 150 operating in 1990) were merged into a new limited company, Savings Bank of Finland (SBF), which immediately adopted a stringent restructuring process. The consequence of the 1992 reforms is that the Finnish savings banks sector has largely disappeared.

In Sweden the savings banks sector was reorganised in 1991 around Swedbank, a commercial banking institution that resulted from the merger of other savings banks alliances. Swedbank subsequently listed on the Stockholm stock exchange. In 1997 Swedbank merged with Föreningsbanken, a bank specialising in the agricultural sector; the new entity is called FöreningsSparbanken. Restructuring/merger activity has also taken place in Denmark and in the Netherlands.

In Italy, Cariplo, a large single savings bank, acts as a 'pole'. In Germany the federal structure of the savings banks group means that the *Landesbanken* act as regional central bankers to the local *Sparkassen*.

The numbers of savings banks have fallen over time through natural attrition. In West Germany the number of *Sparkassen* fell from 591 to 542 between 1984 and 1992. Since the reunification of Germany the number of *Sparkassen* has fallen from 657 in 1994 to 598 in 1997. Natural attrition also occurred in Austria, Norway and Spain between 1984 and 1997. The UK building society sector has been reshaped (downsized) due to a number of conversions by former mutual societies to joint stock banks, and merger and acquisitions activity (see *Table 3.1*).

Italy provides evidence of a different type of structural change: organisational change with respect to the legal structure of banks. The Amato Law of 1990 effectively rendered the Italian banking system homogeneous. All banks organised as joint stock companies and the traditional specialisation of banks disappeared – to be replaced by an adherence to competitive discipline and entrepreneurship. Although savings banks' foundations remain (though not indefinitely), banking operations are carried out by limited companies which are free of the previously restrictive practices that used to characterise Italian banking. The number of savings banks has not fallen significantly (some major banks are former savings banks) but, legally speaking, there is no longer a separate savings bank sector in Italy.

Tables 3.1 and *3.2* identify the numbers of savings banks and their respective branch networks, together with those of the national banking systems, over the period 1984 to 1997. The country with the most savings banks is Germany, where the number of *Sparkassen* was 598 in 1997 (see *Table 3.1*); the *Sparkassen* operated 18,751 branches in 1997 (*Table 3.2*). The Norwegian savings banks sector is the second-largest in terms of numbers of savings banks (133 in 1997), followed by Denmark (111 in 1997) and Sweden (90 in 1997); both the Austrian and Italian savings banks sectors had over 70 savings banks in 1997.

In countries such as Italy, Spain and, to a lesser extent, Austria, the number of savings banks branches has increased continuously since 1984. In Italy and Spain this feature might be partly attributable to legislative changes that have liberalised previous branching restrictions. Another factor could be the attempts made by the relatively-large savings banks sectors in each country to capture a greater market share through increasing the coverage of their branch networks in both rural and urban areas. The trend in the savings banks sector mirrors that of the banking system. This suggests that banks (of all institutional types) have been competing quite extensively for retail deposits and other business, which has been channelled through the branch network due to technological improvements and the growing need to generate additional sources of non-interest income. This same explanation may be applied to the Portuguese banking sector across the entire period (and from 1994–1997 for the savings banks sector).

The common trends in most countries have been bank consolidation and the rationalisation of branch networks. This is true for both the savings banks sectors and banking systems as a whole. Arguably, the two most market-oriented banking systems in Europe are those in the Netherlands and in the UK. In both countries the numbers of savings banks and their branch networks have been reduced due to merger activity and rationalisation programmes. These trends reflect a wider move by the respective banking systems to cut costs through the closure of a number of branches (the Dutch data contain a change in methodology, which means that a comparison of the number of banking system branches between 1984 and 1989 is inappropriate).

In other less market-driven systems such as France and Germany, however, there are opposite trends. The number of branches in France (savings banks and banking system) has remained relatively constant over the time surveyed. The pattern in Germany saw the number of branches increase up to 1994, but since then there has been no move towards the rationalisation of branch networks (for the *Sparkassen* and the banking system) as a whole. In the four Scandinavian countries (Denmark, Finland, Norway and Sweden) the effects of the regional recession of the early-1990s accelerated the trends towards consolidation and rationalisation.

Numbers of Branches: Savings Banks and Banking System (1984–1997)

Country	1984	1989	1992	1994	1996	1997
Savings Banks						
Austria	1,148	1,389	1,494	1,581	1,482	1,465
Belgium[1]	19,849	15,593	12,890	1,369	1,468	2,123
Denmark	1,313	1,119	722	802	360	375
Finland	1,056	1,130	845	233	242	245
France	5,850	4,432	4,411	4,260	4,220	4,220
Germany – *Sparkassen*	17,131	17,359	16,923	19,271	18,895	18,751
Germany – *Landesbanken*	245	219	329	433	436	428
Italy	3,510	4,032	5,240	5,196	5,877	6,047
Netherlands	1,753	999	825	717	665	303
Norway	1,300	1,194	1,105	1,090	1,050	1,012
Portugal	1,440	1,459	1,483	514	685	892
Spain	12,149	14,944	14,291	14,880	16,094	16,653
Sweden	1,261	1,273	1,028	1,012	920	1,398
UK – *Savings Banks*	1,614	1,538	1,369	1,232	1,060	–
UK – *Building Societies*	6,816	6,236	5,765	5,566	4,613	2,537
Banking System						
Austria	4,005	4,378	4,667	4,683	4,694	4,691
Belgium	23,502	19,211	16,405	17,040	10,441	7,358
Denmark	3,515	3,182	2,358	2,245	2,413	2,480
Finland	2,886	3,528	3,087	2,151	1,950	1,745
France	25,490	25,634	25,479	25,389	25,434	25,464
Germany	35,752	39,651	39,295	48,721	47,741	63,186
Italy	13,045	15,683	20,914	23,120	24,406	25,250
Netherlands	5,475	8,006	7,518	7,269	6,694	7,071
Norway	1,940	1,796	1,593	1,552	1,537	1,500
Portugal	1,469	1,741	2,852	3,401	3,842	4,645

Table 3.2

Numbers of Branches: Savings Banks and Banking System (1984–1997)

Country	1984	1989	1992	1994	1996	1997
Spain	31,876	34,511	35,476	35,591	37,079	37,634
Sweden	3,083	3,302	2,910	2,998	2,612	2,505
UK	21,853	20,419	18,218	17,362	16,192	15,253

Footnotes:
1. The number of Belgian savings banks branches in 1994, 1996 and 1997 are those of the two savings banks that are members of the ESBG.

Source: Association Belge des Banques (1998, 1996); Banca d'Italia (1998, 1996); Banco de Portugal (1993, 1995–1997); Bank of England (1998); Bank of Finland (1998); Bank of Spain (1998); British Bankers' Association (1995–1997); Banque de France – CECEI (1996, 1990); Banque de France (1998–1999); BIS (1998); Building Societies Association (1990–1997); Building Societies Commission (1995/96–1997/98); CECA (1990–1997); Danish Securities Council (1990–1997); Deutsche Bundesbank (1997–1998); De Nederlandsche Bank (1990, 1993, 1996–1997); ESBG (1994–1997); EUFI Journal (various); European Central Bank (1999); Finnish Bankers' Association (1995–1997); Nordiska Bankmannaunionen (1997); Norges Bank (1997, 1995, 1993,1990, 1985); OECD (1996, 1994, 1991); Oesterreichische Nationalbank (1990, 1998–1999); Sveriges Riksbank (1998)

Table 3.2 cont'd

Savings Banks' Balance Sheet Composition (1984–1997)

As at 1997, the largest savings banks sectors in the EU (and Norway) were in Germany (the total assets of the *Sparkassen* and the *Landesbanken* being ECU852 billion and ECU843 billion, respectively), Spain (ECU274 billion), Italy (ECU242 billion), France (ECU194 billion) and the UK building societies (ECU174 billion, from ECU409 billion in 1996). Generally speaking, the real assets growth of domestic savings banks sectors has slowed since 1992 in comparison with the earlier periods under review. The total assets of the German *Sparkassen*, for example, grew by over 25 percent between 1992 and 1994, but subsequently fell to 7.4 percent in 1994–1996, and to 4 percent in 1996–1997. During the most recent periods of analysis the Portuguese and Swedish savings banks sectors grew by over 30 percent. These performances could, however, be attributed to factors relating directly to the two large players in each market: Caixa Geral de Depósitos (in Portugal) and Swedbank (in Sweden). A more realistic barometer of strong growth during a tighter macro-economic environment can be found in Belgium, France and Norway, where the savings banks sectors increased their real total assets between 1996 and 1997 by 10.2 percent, 8.1 percent and 9.9 percent, respectively.

Before examining the evolving balance-sheet composition of domestic savings banks sectors, it is appropriate to generalise that some of the key trends that have taken place over the 1984–1997 period. On the assets side of the balance sheet of savings banks, customer lending in 1997 accounted for 40–49 percent of total assets in four sectors (Austria, Denmark, the German *Landesbanken*, Italy and the UK savings bank) and 50–59 percent in five others (Finland, the German *Sparkassen*, Portugal, Spain and Sweden). The importance of customer lending (as a proportion of real total assets) diminished between 1984 and 1997 in eight of the 13 countries under review (Belgium, Denmark, Finland, France, Germany, Portugal, Sweden and the UK building societies). In the remaining five countries, customer lending increased as a proportion of real total assets. This finding illustrates the strategic move made by many European savings banks to re-emphasise their traditional core businesses. Savings banks have grown their customer lending in relation to real total assets in: Austria, Italy, the Netherlands, Norway, Spain and the UK (bank).

In comparing the balance sheet compositions of savings banks sectors for the years 1984 and 1997 it is apparent that the amount of real securities business performed was mixed. Between 1984 and 1997 the ratio of securities business to real total assets increased for four savings banks sectors (Austria, Finland, Germany and Portugal) and the UK building societies (1992–1997). In eight sectors the level fell (Belgium, Denmark, France, the Netherlands, Norway, Spain, Sweden and the UK (bank)). In Italy, the ratio of securities to real total assets largely remained constant (although marginally lower in 1997 compared with earlier years).

On both the assets and liabilities sides of the balance sheet, interbank business has increased quite dramatically. The French savings banks sector holds the greatest proportion of interbank assets (45 percent in 1997). Interbank assets now constitute 20–29 percent of assets business in five savings banks sectors (Austria, Belgium, Denmark, Italy and Sweden); and 10–19 percent in three others (the Netherlands, Portugal and Spain). Interbank liabilities have grown as a means of short-term funding for the majority of savings banks sectors; as at 1997 only the French, Dutch and Spanish savings banks sectors, and the UK savings banks, held less than 10 percent of real liabilities in the form of interbank liabilities. Three savings banks sectors funded their operations using 10–19 percent interbank liabilities (the German *Sparkassen*, Norway and Portugal). In terms of capital and reserves (as a proportion of real liabilities) only the German *Landesbanken* held less than 4 percent in 1997.

A common trend, however, has been the decline in importance of customer deposits as a source of funding and measured as a proportion of real liabilities. In all but two sectors (Finland the UK (bank)) the ratio of customer deposits to real liabilities has fallen; in Portugal and Spain this ratio has remained relatively stable, although there has been a marginal decline. As at 1997 customer deposits as a proportion of real liabilities were in the range of 70–79 percent in six savings banks sectors (France, the Netherlands, Portugal, Spain and the UK bank and building societies); and 60–69 percent in four others (Belgium, Denmark, the German *Sparkassen* and Norway). These data would tend to suggest that most savings banks sectors have altered their funding arrangements (with interbank funding becoming much more important) and that they are using this change to compete more effectively on their assets business.

In *Tables 3.3–3.15* a more detailed picture of balance-sheet composition is presented. The tables show real total assets for 1984, 1989, 1992, 1994, 1996 and 1997. Four assets-side and four liabilities-side items are shown as a percentage of real total assets. In addition, the percentage of staff costs to total assets (in real terms) is also shown.

Table 3.3 shows the evolving balance-sheet composition of the Austrian savings banks sector. This particular sector is characterised by the strength of its bank loans (interbank) business on the assets-side of the balance sheet which, as a proportion of real total assets, is among the highest of the European savings banks sectors, although the ratio has declined over time. Thus, there is evidence that the Austrian savings banks are trying to grow the proportion of customer lending and securities business, possibly at the expense of some of the interbank business.

Balance Sheet Composition:
Austrian Savings Banks (1984–1997) (ECU, mn, real (1996) terms)

Balance Sheet Item	1984	1989	1992	1994	1996	1997
Total Assets	75,406	85,487	113,891	119,891	127,307	132,865
Of which:						
Securities (%)	13.5	11.7	13.2	14.5	15.2	16.9
Non-Bank Loans (%)	48.6	50.2	54.9	53.4	51.4	49.9
Bank Loans (%)	30.6	31.1	26.5	27.1	28.9	25.9
Other Assets (%)	7.3	7.0	5.1	5.0	4.5	7.2
Non-Bank Deposits (%)	47.8	49.4	45.5	43.4	40.6	41.9
Bank Deposits (%)	37.4	32.9	36.0	33.3	34.1	32.5
Capital and Reserves (%)	2.9	4.8	4.0	4.0	4.2	5.1
Other Liabilities (%)	11.9	12.9	14.5	19.3	21.1	20.5
Staff Costs (%)	0.93	1.15	1.25	1.12	1.06	1.00

Source: OECD (1991); BankScope (1999); ESBG (1997, 1996, 1994); Oesterreichische Nationalbank (1999, 1998, 1997, 1990)

Table 3.3

Non-bank deposits fell from 47.8 percent of real total liabilities in 1984 to 41.9 percent in 1997. Again, the bank deposits business has been relatively strong throughout the period compared with the other European savings banks sectors under review; only the German *Landesbanken* have a (slightly) higher volume of bank deposits business. Since 1992 the ratio of staff costs to real total assets has improved (to 1 percent in 1997), making the Austrian savings banks sector one of the most labour cost efficient in Europe.

The Belgian savings banks sector has the highest volume of securities business of any of the sectors under review. In 1997 securities business contributed 37.8 percent of real total assets; this, however, constitutes a decline of over 10 percentage points 1989. One consequence of this concentration in securities business is that customer lending, at around one-third of real total assets, is amongst the lowest found in this study, along with the French savings banks sector and the German *Landesbanken*. Bank loans business has also grown steadily over time and accounted for 35.6 percent of real total assets in 1997.

The liabilities-side of the balance sheet of the Belgian savings banks sector is characterised by a relatively strong commitment to customer deposits that accounted for around 70 percent of real liabilities from 1989 to 1996, before falling to nearly 63 percent in 1997. Between 1984 and 1989 the volume of bank deposits increased nearly threefold at the expense of around a 14 percentage point fall in the proportion of customer deposits to real liabilities. Since 1989 the Belgian savings banks have increasingly used bank deposits as a means of funding. The capital and reserves (at 3.5 percent of real liabilities 1996, and increasing to 4 percent in 1997) is, along with that of the German *Landesbanken*, the lowest in the countries under review.

Balance Sheet Composition:
Belgian Savings Banks (1984–1997) (ECU, mn, real (1996) terms)

Balance Sheet Item	*1984*	*1989*	*1992*	*1994*	*1996*	*1997*
Total Assets	69,522	98,447	117,718	131,495	148,175	163,350
Of which:						
Securities (%)	51.5	49.0	44.9	41.6	40.8	37.8
Non-Bank Loans (%)	38.4	34.3	34.7	36.6	34.2	35.6
Bank Loans (%)	2.5	9.7	14.5	18.1	21.4	22.3
Other Assets (%)	7.6	7.0	5.9	3.7	3.6	4.3
Non-Bank Deposits (%)	83.2	69.8	68.2	70.7	67.2	62.5
Bank Deposits (%)	6.1	16.9	18.0	17.5	24.6	25.7
Capital and Reserves (%)	2.9	3.8	3.4	3.5	3.5	4.0
Other Liabilities (%)	7.8	9.5	10.4	8.7	4.7	7.8
Staff Costs (%)	1.04	0.91	0.85	0.83	0.73	0.60

Source: OECD (1994), BankScope (1999)

Table 3.4

Since 1989 the Belgian savings banks sector has consistently improved its labour-cost efficiency; only the German *Landesbanken* and the UK building societies are more labour-cost efficient (see *Table 3.4*).

The restructuring of the Danish savings banks sector is apparent in *Table 3.5* which shows that real total assets fell from ECU43,206 million in 1989 to ECU9,865 million in 1997. Across 1994 and 1997 the assets-side of the balance sheet of the reconfigured savings banks sector is characterised by a relatively high (for European savings banks sectors) volume of securities business, with over 40 percent of real assets tied up in customer lending. In 1996, the reconfigured Danish savings banks sector had the highest proportion of real liabilities held in the form of capital and reserves (11.4 percent), and although capital strength reduced to approximately 7 percent in 1997 the data suggest that attaining solvency or strength is a key strategy of the sector. The funding arrangements of the sector by 1997 consisted of 60.7 percent customer deposits and 27.0 percent bank deposits. The labour-cost efficiency of the Danish sector has significantly improved between 1994 and 1997, from 1.96 percent to 1.38 percent, thus making the sector more comparable in terms of cost efficiency with other European savings banks sectors.

Finland's savings banks sector was extensively restructured in 1992. With market share in decline, concerns have been voiced over the sector's continuing existence. The limited 1997 data shows the relative importance the savings banks are placing on the collection of customer deposits through their geographically diversified branch network. The volume of customer lending has also increased to 58.9 percent of real total assets from 40.9 percent in 1994. In terms of strength, the ratio of capital and reserves to real liabilities has recovered to 5.6 percent (in 1996), which is higher than in any of the years under review (except 1989) (see *Table 3.6*).

Balance Sheet Composition: Danish Savings Banks (1984–1997) (ECU, mn, real (1996) terms)

Balance Sheet Item	1984	1989	1992	1994	1996	1997
Total Assets	26,380	43,206	22,387	21,602	10,359	9,865
Of which:						
Securities (%)	30.8	22.3	22.5	27.4	28.2	26.4
Non-Bank Loans (%)	43.5	48.5	58.1	49.6	51.6	41.1
Bank Loans (%)	8.0	11.9	10.8	17.4	13.4	25.0
Other Assets (%)	17.7	17.3	8.6	5.6	6.8	7.5
Non-Bank Deposits (%)	61.8	51.2	60.1	65.5	65.2	60.7
Bank Deposits	12.1	24.6	23.3	19.4	17.4	27.0
Capital and Reserves (%)	10.8	9.6	6.9	7.0	11.4	6.9
Other Liabilities (%)	15.3	14.6	9.7	8.1	6.0	5.4
Staff Costs (%)	–	2.13	1.91	1.96	1.27	1.38

Source: EUFI Journal (various); BankScope (1999); ESBG (1997); Danish Securities Council (1990–1997)

Table 3.5

Balance Sheet Composition: Finnish Savings Banks (1984–1997) (ECU, mn, real (1996) terms)

Balance Sheet Item	1984	1989	1992	1994	1996	1997
Total Assets	12,373	24,875	21,420	8,018	4,092	4,538
Of which:						
Securities (%)	3.9	6.6	4.3	11.7	–	–
Non-Bank Loans (%)	71.1	69.2	64.8	40.9	58.6	58.9
Bank Loans (%)	9.7	7.1	6.8	3.8	–	–
Other Assets (%)	15.3	17.1	24.1	43.6	–	–
Non-Bank Deposits (%)	78.7	58.8	58.5	36.5	84.5	8.5
Bank Deposits	0.01	0.2	0.1	0.03	–	–
Capital and Reserves (%)	4.7	6.7	5.4	3.4	5.6	–
Other Liabilities (%)	16.6	34.3	36.0	60.1	–	–
Staff Costs (%)	2.44	1.66	1.40	1.14	–	–

Source: ESBG (1997, 1996); OECD (1996, 1994)

Table 3.6

Balance Sheet Composition: French Savings Banks (1984–1997) (ECU, mn, real (1996) terms)

Balance Sheet Item	*1984*	*1989*	*1992*	*1994*	*1996*	*1997*
Total Assets	143,431	184,617	148,124	158,531	179,261	193,779
Of which:						
Securities (%)	24.0	0.5	8.6	13.9	15.2	17.4
Non-Bank Loans (%)	47.4	21.2	31.4	31.9	31.0	31.0
Bank Loans (%)	24.9	74.6	53.6	49.1	45.3	45.0
Other Assets (%)	3.7	3.7	6.4	5.1	8.5	6.6
Non-Bank Deposits (%)	90.3	62.7	80.2	83.5	78.0	76.5
Bank Deposits	0.1	33.1	5.3	9.5	2.2	3.2
Capital and Reserves (%)	7.6	2.3	4.1	4.4	5.5	5.1
Other Liabilities (%)	2.0	1.9	10.4	2.6	14.3	15.2
Staff Costs (%)	–	0.77	1.18	1.21	1.16	1.08

Source: EUFI Journal (various); OECD (1996); CENCEP (1994–1997)

Table 3.7

The French savings banks sector was restructured in June 1991. After this date the sector consisted of 35 savings banks, which were located along regional lines and were organised around a central institution, CENCEP. Later, a central banking institution, the CCCEP, was set up in 1995. The French savings banks sector has been one of the most heavily regulated sectors in Europe. The sector essentially collects customer deposits and lodges them with the government-owned CDC (Caisse des Dépôts et Consignations) which invests the funds and uses the proceeds to finance state housing programmes. It is only recently that the savings banks have been allowed to make customer loans (1981) and lend to SMEs (1987). Thus, in the increasingly competitive market for customer lending the savings banks have had to catch up their rivals. This explains the large discrepancy between the volume of customer lending and the volume of customer deposits for the French savings banks (see *Table 3.7*).

Since the sector was restructured in 1991 the French savings banks have increased their securities business from 0.5 percent of real total assets in 1989 to 17.4 percent in 1997. The strategic moves towards increasing the volume both of securities and customer lending business has been made at the expense of bank loans business, which has declined from 74.6 percent of real total assets in 1989 to 45.0 percent in 1997. Despite the decline in bank loans business the French savings banks hold the largest proportion of bank loans to real total assets of any savings banks sector under review.

On the liabilities-side of the balance sheet customer deposits have accounted for around 80 percent of real liabilities post-restructuring. During the 1980s a fundamental problem that faced the French savings banks sector, and one which led to an earlier process of rationalisation through increased merger activity, was that of capital adequacy. This can be seen in *Table 3.7*, which shows the fall in the amount of capital and reserves relative to real liabilities from 7.6 percent in 1984 to 2.3 percent in 1989. The importance placed by the authorities and

Balance Sheet Composition: German Savings Banks (1984–1997) (ECU, mn, real (1996) terms)

Balance Sheet Item	1984	1989	1992	1994	1996	1997
Sparkassen						
Total Assets	485,125	586,548	608,843	763,006	819,144	851,933
Of which:						
Securities (%)	19.0	21.8	21.5	26.8	26.2	27.1
Non-Bank Loans (%)	65.8	61.3	63.8	60.9	59.9	59.7
Bank Loans (%)	8.2	10.5	8.6	7.7	8.0	8.2
Other Assets (%)	7.0	6.4	6.1	4.6	5.9	5.0
Non-Bank Deposits (%)	79.6	74.8	72.1	69.6	66.6	65.3
Bank Deposits	9.4	10.4	11.0	13.9	17.4	18.9
Capital and Reserves (%)	3.6	3.8	3.8	3.4	4.0	4.0
Other Liabilities (%)	7.4	11.3	13.1	13.1	12.0	11.8
Staff Costs (%)	1.42	1.36	1.46	1.34	1.26	1.22
Landesbanken						
Total Assets	380,014	466,843	609,534	745,416	780,042	842,737
Of which:						
Securities (%)	10.4	9.5	14.7	16.1	17.5	17.3
Non-Bank Loans (%)	60.5	48.6	48.7	48.2	40.8	39.6
Bank Loans (%)	26.5	39.3	34.3	33.0	38.4	39.4
Other Assets (%)	2.6	2.6	2.3	2.7	3.3	3.7
Non-Bank Deposits (%)	19.5	24.5	24.2	24.9	19.2	18.4
Bank Deposits	26.8	29.3	34.5	34.0	35.4	37.6
Capital and Reserves (%)	2.2	2.2	2.8	2.9	3.3	3.5
Other Liabilities (%)	51.5	44.0	38.5	40.2	42.1	40.5
Staff Costs (%)	0.32	0.31	0.32	0.26	0.30	0.25

Source: EUFI Journal (various); BankScope (1999); OECD (1996, 1994); Deutsche Bundesbank (1997–1998)

Table 3.8

savings banks on improving the strength of the sector is manifested in the continued increase in capital and reserves from 1989 to the 1997 figure of 5.1 percent. In contrast to their relatively high volume of bank loans business, in 1997 the French savings banks had the lowest volume of bank deposits business of any of the sectors under review (at 3.2 percent of real liabilities).

The largest savings banks group is found in Germany (see *Table 3.8*). The Federal three-tiered structure has at its base the *Sparkassen* or local savings banks that had total assets of ECU852 billion in 1997. At the second tier are the *Landesbanken*: a set of thirteen institutions the *Landesbanken* act as regional central banks to the *Sparkassen* and as banker to the host *Länder*. In addition the

Landesbanken operate commercial banking activities: their main business is wholesale. The *Landesbanken* provide products and services which are available to all savings banks group customers; the extensive *Sparkassen* branch network is used as a major retail outlet for the *Landesbanken* in addition to the 428 branches they operate.

Table 3.8 shows that the *Sparkassen* recorded strong real total assets growth between 1984 and 1989 and 1992 and 1994. Over the period of analysis, the volume of securities business has risen from 19.0 percent of real total assets in 1984 to 27.1 percent in 1997. While securities business has increased the volume of customer lending has fallen by nearly 6 percentage points to 59.7 percent in 1997; this volume of customer lending still makes the *Sparkassen* one of leading savings banks sectors in terms of credit provision. Like the Norwegian savings banks sector and the UK building societies, the German *Sparkassen* have a relatively small amount of bank loans business: for the years under review the *Sparkassen* held an average of bank loans which were equivalent to 8.5 percent of real total assets (see *Table 3.8*).

The *Sparkassen* would appear to be shifting their funding arrangements away from traditional customer deposits to bank deposits. Between 1984 and 1997 the volume of customer deposits fell from 79.6 percent of real liabilities to 65.3 percent. During the same period the volume of bank deposits nearly doubled; in 1997 bank deposits accounted for 18.9 percent of real liabilities. The *Sparkassen* are, however, one of the savings banks sectors which is relatively weak as measured by the amount of capital and reserves to real liabilities averaging 3.77 percent over the years analysed. There is evidence that the *Sparkassen* have been relatively successful at improving their labour-cost efficiency over time.

The *Landesbanken* realised real total assets growth of over 20 percent in the periods 1984–1989, 1989–1992 and 1992–1994, after which growth has slowed to less than 5 percent between 1994 and 1996, before recovering to 8 percent for the period 1996 to 1997 (see *Table 3.8*). The wholesale business orientation of the *Landesbanken* is reflected in the relatively high and increased volume of bank assets business and relatively low volume of customer lending. In fact, customer lending has declined as a proportion of real total assets by approximately 20 percentage points over the period. The *Landesbanken* are not collectors of retail or customer deposits: this function is entrusted to the *Sparkassen*.

The liabilities-side of the balance sheet is characterised by an increased amount of bank deposits business, which accounted for 37.6 percent of real liabilities in 1997, the highest of all the sectors under review. Another feature is the extremely high volume of other liabilities business (40.5 percent in 1997): the main line of this business being bearer bonds and money market paper. The *Landesbanken* were found to be the most labour cost efficient of the savings banks sectors reviewed. At 1997 the ratio of *Landesbanken* staff costs to real total assets was 0.25 percent.

The Italian banking system was hard hit in 1992 and 1994 by falling levels of gross income caused first, by a reduction in net interest revenue and secondly, by decreasing non-interest income. The root cause of this being mainly cyclical economic factors. Growth in real total assets in the savings banks sector slowed to less than 2 percent between 1994 and 1996, before falling by over 12 percent across 1996 and 1997. The savings banks sector underwent a fundamental change in 1991 with the passage of the Amato Law, the aim of which was to facilitate the conversion of savings banks into joint stock companies. Since Amato, there has been much speculation about the future organisational structures

Balance Sheet Composition: Italian Savings Banks (1984–1997) (ECU, mn, real (1996) terms)

Balance Sheet Item	*1984*	*1989*	*1992*	*1994*	*1996*	*1997*
Total Assets	194,403	244,886	252,926	270,592	275,880	241,883
Of which:						
Securities (%)	28.2	19.1	15.4	25.1	26.0	24.7
Non-Bank Loans (%)	28.1	31.2	36.4	45.6	44.8	47.1
Bank Loans (%)	11.6	7.6	8.2	19.2	21.3	20.8
Other Assets (%)	32.1	42.1	40.0	10.1	7.9	7.4
Non-Bank Deposits (%)	64.1	54.0	51.9	51.5	49.5	45.4
Bank Deposits	4.4	4.8	6.4	23.0	24.1	25.2
Capital and Reserves (%)	5.2	6.9	10.6	8.6	8.3	8.1
Other Liabilities (%)	28.4	34.3	31.1	16.9	18.1	21.1
Staff Costs (%)	2.35	1.97	2.15	1.91	1.55	1.72

Source: OECD (1996, 1994); ESBG (1997, 1996); BankScope (1999); EUFI Journal (various); Banca d'Italia (1996–1998)

Table 3.9

of savings banks. Both the Dini Directive of 1994 and the Ciampi Directive of 1997 have sought to reconcile the issue.

In Italy in 1997, savings banks customer lending accounted for 47.1 percent of real total assets. This volume of business, however, represents nearly a 70 percent increase on 1984. The Italian savings banks sector has also increased its bank loans business and it has one of the highest volumes of securities business of European savings banks sectors (at 1997) (see *Table 3.9*). The evolution of the assets-side business was paralleled by a substantial decrease, between 1984 and 1992, in other assets business.

Since 1984 there has been a relatively large fall in the volume of customer deposits and a roughly equivalent increase in the volume of bank deposits business (see *Table 3.9*) as the savings banks have made increasing use of the developing Italian money markets. Since 1992 the Italian savings banks sector has become much stronger in terms of the level of capital and reserves to liabilities. In addition, labour-cost efficiency gains have also been realised, although the sector remains one of the least labour-cost efficient of all the European savings banks sectors under review.

The savings banks sector in the Netherlands is one of the smallest in Europe. Over time, a consolidation process has seen the number of savings banks reduce as a result of merger activity. The largest savings bank, SNS, holds is an all-purpose bank ('algemeene bank'). It has an insurance partner and is organised according to the *Allfinanz* concept. Since 1989 the volume of customer lending business has increased sharply to account for 81.4 percent of total assets as at 1997. The growth in customer lending would appear to have taken place at the expense of other assets business. Since 1989 bank loans, securities and other assets business have all declined (see *Table 3.10*).

**Balance Sheet Composition:
Dutch Savings Banks (1984–1997) (ECU, mn, real (1996) terms)**

Balance Sheet Item	*1984*	*1989*	*1992*	*1994*	*1996*	*1997*
Total Assets[1]	16,045	20,700	23,527	25,745	27,946	15,545
Of which:						
Securities (%)	24.0	18.2	15.2	12.6	9.9	7.9
Non-Bank Loans (%)	64.4	59.4	58.2	67.7	73.4	81.4
Bank Loans (%)	5.0	15.8	20.2	13.8	11.9	7.0
Other Assets (%)	6.6	6.6	6.4	5.6	4.8	3.7
Non-Bank Deposits (%)	89.8	78.8	73.2	74.5	71.0	75.9
Bank Deposits	0.9	1.1	5.2	8.6	10.3	9.0
Capital and Reserves (%)	8.3	9.5	7.3	5.4	4.9	5.3
Other Liabilities (%)	1.0	10.6	14.3	11.5	13.8	9.8
Staff Costs (%)	–	–	–	–	0.78	0.91

Footnote:
1. The total assets figure for 1996 is as at 1995.

Source: EUFI Journal (various); BankScope (1999); ESBG (1994–1997)

Table 3.10

As with a number of European savings banks sectors, the structure of funding is changing for the Dutch savings banks with customer deposits falling and bank deposits rising as a proportion of liabilities. Yet, in spite of this trend, the volume of customer deposits remained relatively high and the volume of bank deposits relatively low in comparison with other savings banks sectors. Another area of growth has been in other liabilities but the volume of capital and reserves has been falling since 1989 and stood at 5.3 percent in 1997 (see *Table 3.10*).

The regional banking system crisis that hit the Scandinavian economies at the turn of the 1990s brought about a fall in the real growth of total assets of the Norwegian savings banks sector between 1989 and 1992. The Norwegian savings banks sector has the highest amount of assets business in the form of customer lending. In fact, the volume of customer lending grew steadily from 66.7 percent in 1984 to 84.8 percent in 1997. While bank loans business is not so important for the sector, the volume of securities business has declined as customer lending has grown. The customer deposits business appears quite variable. While the years 1992 and 1994 saw a higher proportion of customer deposits being collected compared with 1989, there was a return towards the 1989 level in 1996 only for the ratio to fall off in 1997. Bank deposits business increased between 1994 and 1997 but only the French savings banks sector has a smaller volume of this type of business. Since 1989 the savings banks sector has become stronger in terms of capital and reserves, accounting for over 10 percent of liabilities as at 1996 and 1997, making this sector one of the strongest under review. Furthermore, *Table 3.11* shows that labour-cost efficiency gains have been realised over time.

The Portuguese savings banks sector is dominated by the large banking institution, Caixa Geral de Depòsitos. Since 1992 the sector (or *Caixa Geral*) has

Balance Sheet Composition: Norwegian Savings Banks (1984–1997) (ECU, mn, real (1996) terms)

Balance Sheet Item	1984	1989	1992	1994	1996	1997
Total Assets	20,400	35,308	32,685	34,436	39,642	43,559
Of which:						
Securities (%)	28.0	16.8	11.3	10.8	9.4	7.8
Non-Bank Loans (%)	66.7	76.9	81.8	82.8	84.1	84.8
Bank Loans (%)	3.6	1.8	2.3	2.2	3.0	3.7
Other Assets (%)	1.7	4.5	4.6	4.2	3.5	3.7
Non-Bank Deposits (%)	84.6	68.9	79.2	77.5	70.6	64.2
Bank Deposits	5.4	6.7	4.7	3.5	7.3	10.1
Capital and Reserves (%)	5.9	4.5	5.6	7.8	10.4	10.2
Other Liabilities (%)	4.1	19.9	10.5	11.2	11.7	15.5
Staff Costs (%)	1.78	1.41	1.46	1.36	1.16	1.08

Source: OECD (1996, 1994); The Norwegian Savings Banks Association (1997, 1996, 1995b, 1994a)

Table 3.11

achieved considerable real total assets growth. The data show some noticeable changes in the composition of assets: from 1989, an increased volume of securities business; from 1994, a threefold increase in the volume of bank loans business; and since 1992 a significant reduction in other assets business. There has been a gradual decrease in the volume of customer lending, although a slight upturn occurred between 1994 and 1996 and 1996 to 1997.

The liabilities business has remained concentrated in customer deposits. As at 1997 the volume of customer deposits business accounted for nearly 75 percent of liabilities – one of the highest amongst the savings banks sectors under review. While bank deposits have grown since 1989 they are not as significant as in other savings banks sectors. The data suggest that the Portuguese savings banks have been using some of their capital and reserves to fund other business activities, yet, as at 1997, capital and reserves accounted for 5.2 percent of liabilities. Labour-cost efficiency has improved since 1989 and stood at 1.26 percent in 1997 (see *Table 3.12*).

Like their Portuguese neighbours, the Spanish savings banks have reduced their other assets business over time. This has enabled the Spanish savings banks to double the volume of bank loans business between 1984 and 1997 and to increase customer lending to over 50 percent of assets by 1997 (see *Table 3.13*). Although the volume of securities business fell between 1989 and 1992, it has been increasing since then and by 1997 it was approaching a level comparable with the 1980s.

The increased competition for retail deposits, which has become particularly strong both in Spain and Portugal, was noted earlier in the chapter. One measure of the relative success of the Spanish savings banks is the volume of customer deposits business, which has been increasing since 1992 peaking at 79.4 percent in 1996. Only the Finnish savings banks recorded a greater volume of customer deposits business. The Spanish savings banks have also made increased use of bank deposits as a source of funds. Although the labour-cost efficiency of the sector was much improved by 1997, there is still room for improvement as the sector is among the least labour-cost efficient in Europe after the Danish and Italian savings banks sectors and the UK savings bank.

Balance Sheet Composition: Portuguese Savings Banks (1984–1997) (ECU, mn, real (1996) terms)

Balance Sheet Item	*1984*	*1989*	*1992*	*1994*	*1996*	*1997*
Total Assets	16,881	27,153	27,423	33,976	46,552	42,694
Of which:						
Securities (%)	3.1	18.0	19.5	20.7	20.1	21.2
Non-Bank Loans (%)	58.3	46.7	45.3	42.8	46.6	50.3
Bank Loans (%)	6.6	8.1	9.5	27.1	22.2	19.3
Other Assets (%)	32.2	27.2	25.7	9.4	11.1	9.2
Non-Bank Deposits (%)	75.8	79.1	74.3	73.3	78.1	74.5
Bank Deposits	3.6	2.9	8.9	13.8	11.1	13.3
Capital and Reserves (%)	6.9	9.8	11.6	7.2	5.6	5.2
Other Liabilities (%)	13.7	8.2	5.2	5.7	5.2	7.0
Staff Costs (%)	–	1.83	1.26	1.30	1.25	1.26

Source: ESBG (1997, 1996, 1994); BankScope (1999); EUFI Journal (various)

Table 3.12

Balance Sheet Composition: Spanish Savings Banks (1984–1997) (ECU, mn, real (1996) terms)

Balance Sheet Item	*1984*	*1989*	*1992*	*1994*	*1996*	*1997*
Total Assets	120,608	188,926	215,535	245,660	264,482	273,946
Of which:						
Securities (%)	28.7	27.1	19.6	21.3	25.4	23.8
Non-Bank Loans (%)	38.6	41.3	47.0	47.9	48.0	53.3
Bank Loans (%)	8.2	10.5	16.0	13.1	19.6	15.2
Other Assets (%)	24.5	21.1	17.4	17.7	7.0	7.7
Non-Bank Deposits (%)	75.7	76.3	73.2	74.8	79.4	73.2
Bank Deposits	7.3	3.2	5.1	6.6	11.6	9.7
Capital and Reserves (%)	7.6	7.2	8.1	8.6	5.5	6.5
Other Liabilities (%)	9.4	13.3	13.6	10.0	3.5	10.6
Staff Costs (%)	2.29	2.00	1.60	1.51	1.43	1.44

Source: OECD (1996, 1994); EUFI Journal (various); ESBG (1997, 1996); BankScope (1999); CECA (1990–1997)

Table 3.13

Balance Sheet Composition:
Swedish Savings Banks (1984–1997) (ECU, mn, real (1996) terms)

Balance Sheet Item	*1984*	*1989*	*1992*	*1994*	*1996*	*1997*
Total Assets	28,226	36,039	43,348	42,258	62,889	85,056
Of which:						
Securities (%)	23.4	13.4	18.5	27.2	22.7	16.2
Non-Bank Loans (%)	59.8	72.8	64.3	52.7	46.8	50.7
Bank Loans (%)	12.3	8.7	6.6	13.8	21.0	24.3
Other Assets (%)	4.5	5.1	10.6	6.3	9.5	8.8
Non-Bank Deposits (%)	85.1	66.4	59.3	59.3	51.5	52.3
Bank Deposits	4.2	22.1	14.7	23.0	28.6	25.4
Capital and Reserves (%)	7.6	7.5	6.5	6.7	4.7	4.5
Other Liabilities (%)	3.1	4.0	19.5	11.0	15.2	17.8
Staff Costs (%)	1.55	1.68	1.71	1.39	1.33	1.39

Note: The 1996 total assets figure relates to 1995 for the savings banks sector while the balance sheet composition is for Swedbank (unconsolidated) and for 1996.

Source: OECD (1996, 1994); ESBG (1997, 1996, 1995); BankScope (1999)

Table 3.14

Table 3.14 shows the balance sheet of the Swedish savings banks sector. The savings banks sector was restructured in 1991 through a merger process, which created Swedbank, a central institution around which the 90 savings banks are organised. Since restructuring, the volume of customer lending has been significantly Reduced, from 72.8 percent of assets in 1989 to 50.7 percent in 1997. Increased volumes of securities, bank loans, and other assets business have accompanied this move. The subsequent merger between Swedbank and Föreningsbanken increased real total assets by over 35 percent between 1996 and 1997. The 1997 data show a greater orientation towards customer lending and bank lending in terms of assets business, while the composition of liabilities business is relatively unchanged (see *Table 3.14*).

The restructuring process would appear to have moved the savings banks away from their traditional deposit-collecting position to a more commercial banking orientated one. This is largely the result of the creation of Swedbank, which is now a listed limited liability commercial banking company. In 1984 customer deposits accounted for roughly 85 percent of liabilities but by 1997 the volume had been reduced to 52.3 percent. There has also been significant growth in the volume of bank deposits business and Swedish savings banks have one of the highest volumes of bank loans business, of the European savings banks sectors. Other liabilities business has increased but capital and reserves fell between 1994 and 1997. Since restructuring, the sector improved its labour-cost efficiency to 1.39 percent in 1997.

The UK savings banks sector is slightly different from its European counterparts. While there is no doubting the role played by the UK in the origins of savings banking, the sector underwent a substantial and fundamental change in the mid-1980s with the floatation in the UK of the Trustees Savings Bank

Group. Since then the TSB has merged with Lloyds Bank to form LloydsTSB in 1996. Yet, the new larger institution remains a member organisation of the ESBG (European Savings Banks Group). The data shown as "Savings Bank" in *Table 3.15* refer to the TSB Bank, as there is only one UK savings bank. The UK has a relatively large building society sector, which is included in this analysis because building societies are characterised by their mutuality, a feature shared by a number of European savings banks sectors (see *Table 3.15*).

Balance Sheet Composition:
UK Savings Banks (1984–1997) (ECU, mn, real (1996) terms)

Balance Sheet Item	*1984*	*1989*	*1992*	*1994*	*1996*	*1997*
Savings Bank						
Total Assets	27,624	44,566	40,260	38,872	34,709	35,481
Of which:						
Securities (%)	18.1	10.4	6.6	10.2	4.7	0.02
Non-Bank Loans (%)	51.3	59.6	62.3	67.9	78.2	40.1
Bank Loans (%)	14.9	23.8	25.1	14.2	10.8	54.1
Other Assets (%)	15.7	6.2	6.0	7.7	6.2	5.78
Non-Bank Deposits (%)	59.6	85.3	87.2	59.4	69.2	79.8
Bank Deposits	2.5	–	–	15.6	15.7	5.4
Capital and Reserves (%)	6.3	7.3	5.9	6.2	7.4	7.3
Other Liabilities (%)	31.6	7.4	6.9	18.8	7.7	7.5
Staff Costs (%)	–	–	–	1.70	2.11	1.82
Building Societies						
Total Assets	–	335,124	398,553	420,257	408,719	173,999
Of which:						
Securities (%)	–	–	7.4	9.9	10.7	10.0
Non-Bank Loans (%)	–	79.4	78.1	76.1	72.8	81.8
Bank Loans (%)	–	10.3	10.5	10.0	9.5	6.8
Other Assets (%)	–	–	4.0	4.0	7.0	1.4
Non-Bank Deposits (%)	–	75.6	71.8	70.8	70.7	70.0
Bank Deposits	–	5.3	18.0	18.8	18.5	22.1
Capital and Reserves (%)	–	–	5.1	5.8	5.8	5.9
Other Liabilities (%)	–	–	5.1	4.6	5.0	2.0
Staff Costs (%)	–	–	0.45	0.46	0.48	0.47

Source: ESBG (1996, 1994); BankScope (1999); EUFI Journal (various); Building Societies Association (1990–1997); Bank of England (1998, 1997); British Bankers' Association (1998, 1996, 1995)

Table 3.15

The UK savings bank has seen its real assets decline continuously since 1989. Throughout the period, however, the volume of customer lending has grown to one of the highest levels among the European savings banks sectors. In contrast to other European savings banks sectors, the UK savings bank had reduced its bank loans business to just over 10 percent by 1996. There is not a pronounced trend in the volume of securities business, which fluctuated across the period.

The volume of customer deposits has also varied. In 1989 and 1992 customer deposits accounted for over 85 percent of liabilities but dropped significantly in 1994 before returning to over 80 percent in 1997. The bank deposits business remained constant at around 15 percent of liabilities in 1994 and 1996, but grew to 22.1 percent in 1997. Since 1992 the capital and reserves strength of the savings bank has increased from 5.9 percent to 7.3 percent in 1997. The assets data for 1997, however, are not consistent with earlier years: this suggests that reorganisation within the LloydsTSB group is re-orientating the business activities of TSB Bank. In 1997, for example, customer lending accounted for about 40 percent and bank lending for over 54 percent of balance sheet total, compared with 78.2 percent and 10.8 percent, respectively in 1996.

Although there is little information relating to labour-cost efficiency, the data that are available show a deterioration between 1994 and 1996, which made the UK savings bank the least labour-cost efficient in Europe. However, some improvement did occur between 1996 and 1997. In contrast to the savings bank, the UK building societies, at 0.47 percent, are second only to the German *Landesbanken*, at 0.25 percent, in terms of labour-cost efficiency.

Market Share Analysis (1984–1997)

The relative performances of the savings banks are indicated in *Tables 3.16–3.18*, which show the savings banks' market share of banking assets, customer deposits and customer loans over the period 1984–1997.

Table 3.16 shows the developing assets market share of European savings banks sectors.

Those savings banks with the largest share of domestic banking system assets are found in Germany, Norway, Spain and Austria: in each country the savings banks sector accounted for over 30 percent of banking system assets as at 1997. It should be noted that both the German *Sparkassen* and *Landesbanken* have been losing market share over time though this statistic should not undermine their importance in the fragmented German banking system. Since 1992 each of the four above savings banks sectors have lost (albeit to varying degrees) some assets market share. The structural reorganisation of savings banks that took place in Denmark and Finland caused assets market share to fall sharply from the relatively sizeable percentage of the 1980s and early 1990s. This is also the case in the Netherlands, but to a much lesser extent.

From their beginnings savings banks have been traditional retail bankers to (non-bank) customers across Europe. In *Table 3.17* customer deposits market share data shows that the savings banks, in a number of European countries, have maintained and consolidated this position, and at a time when competition for relatively cheap retail deposits has increased. The recent pan-European strategic move by banks of varying institutional type to return to and develop core banking businesses would appear to have benefited the savings banks, whose comparative and traditional advantage lies in the provision of such

Savings Banks Market Share of Banking System Assets (1984–1997) (%)

Country	*1984*	*1989*	*1992*	*1994*	*1996*	*1997*
Austria	24.5	24.6	31.0	31.1	30.9	30.8
Belgium	20.7	18.6	21.0	21.8	21.9	22.8
Denmark[1]	23.7	26.4	15.6	15.2	5.8	–
Finland	17.1	17.7	15.0	6.5	3.9	–
France	–	7.5	5.5	6.4	5.3	6.2
Germany – *Sparkassen*	28.0	26.2	23.5	24.6	19.3	18.6
Germany – *Landesbanken*	21.9	20.9	23.5	24.0	18.4	18.4
Italy[2]	24.1	25.8	21.6	23.7	20.8	20.1
Netherlands[3]	5.9	4.4	3.8	3.9	3.5	2.2
Norway	38.6	40.3	39.1	43.9	33.7	32.1
Portugal	20.9	29.3	23.9	24.2	20.4	26.3
Spain	28.4	36.1	35.4	33.4	32.3	35.0
Sweden	19.3	17.5	21.9	37.1	–	–
UK – *Savings Banks*[2]	–	2.0	1.9	1.8	1.4	1.1
UK – *Building Societies*	–	15.3	19.0	19.2	16.0	5.6

Footnotes:
1. The market share data for Danish savings banks in 1984 relates to 1985.
2. The market share data for Italian savings banks in 1989 relates to 1990.
3. The market share data for Dutch savings banks in 1992 relates to 1990.

Source: Association Belge des Banques (1998, 1996); Banca d'Italia (1998, 1996); Banco de Portugal (1993, 1995–1997); Bank of England (1998); Bank of Finland (1998); Bank of Spain (1998); British Bankers' Association (1995–1997); Banque de France – CECEI (1996, 1990); Banque de France (1998–1999); BIS (1998); Building Societies Association (1990–1997); Building Societies Commission (1995/96–1997/98); CECA (1990–1997); Danish Securities Council (1990–1997); Deutsche Bundesbank (1997–1998); De Nederlandsche Bank (1990, 1993, 1996–1997); ESBG (1994–1997); EUFI Journal (various); European Central Bank (1999); Finnish Bankers' Association (1995–1997); Nordiska Bankmannaunionen (1997); Norges Bank (1997, 1995, 1993,1990, 1985); OECD (1996, 1994, 1991); Oesterreichische Nationalbank (1990, 1998–1999); Sveriges Riksbank (1998)

Table 3.16

products and services. At a time when competition has intensified the savings banks sectors in both Spain and Portugal have increased their customer deposit market shares.

In four of the countries listed in *Table 3.17* the savings banks sectors accounted for around 40 percent of customer deposits in 1997: Spain (49.3 percent); Norway (44.9 percent); Germany (39.8 percent); and Portugal (39.1 percent). It is interesting to compare the respective market share data for the French savings banks. While assets and customer lending market shares are below 10 percent (see *Table 3.16* and *Table 3.18*), the customer deposits market share is around 20 percent throughout the period under review. The French savings banks are

Savings Banks Market Share of Banking System Deposits (1984–1997) (%)

Country	1984	1989	1992	1994	1996	1997
Austria	30.8	29.1	33.5	32.8	31.7	32.2
Belgium	59.6	38.3	39.5	44.5	41.5	30.7
Denmark	28.1	28.9	17.4	17.9	7.1	7.5
Finland	20.7	20.6	17.0	6.1	6.5	7.5
France	–	20.3	18.7	19.8	17.9	17.0
Germany – *Sparkassen*	41.7	37.2	32.9	34.8	34.5	31.1
Germany – *Landesbanken*	8.0	9.7	11.1	12.2	9.8	8.7
Italy	26.6	25.4	24.2	27.1	27.3	27.0
Netherlands	11.1	7.3	6.0	6.5	5.9	4.6
Norway	44.9	47.4	46.4	45.0	47.4	44.9
Portugal	21.0	31.7	27.1	31.6	29.6	39.1
Spain	35.4	44.1	46.2	48.8	46.4	49.3
Sweden	28.9	27.0	26.8	21.7	26.6	28.3
UK – *Savings Banks*	–	2.5	2.4	1.5	1.4	1.3
UK – *Building Societies*	–	17.0	19.5	19.2	16.5	6.1

Source: Association Belge des Banques (1998, 1996); Banca d'Italia (1998, 1996); Banco de Portugal (1993, 1995–1997); Bank of England (1998); Bank of Finland (1998); Bank of Spain (1998); British Bankers' Association (1995–1997); Banque de France – CECEI (1996, 1990); Banque de France (1998–1999); BIS (1998); Building Societies Association (1990–1997); Building Societies Commission (1995/96–1997/98); CECA (1990–1997); Danish Securities Council (1990–1997); Deutsche Bundesbank (1997–1998); De Nederlandsche Bank (1990, 1993, 1996–1997); ESBG (1994–1997); EUFI Journal (various); European Central Bank (1999); Finnish Bankers' Association (1995–1997); Nordiska Bankmannaunionen (1997); Norges Bank (1997, 1995, 1993, 1990, 1985); OECD (1996, 1994, 1991); Oesterreichische Nationalbank (1990, 1998–1999); Sveriges Riksbank (1998)

Table 3.17

accused by their competitors of having the competitive advantage of collecting Livret A deposits.[1] Yet, the downward pressure on the savings banks' market share is indicative of the intense competition in this particular market segment, in which the savings banks sector are the second most important financial group.

In the current competitive environment, savings banks, as part of their strategic plan to position themselves as a European-wide banking group in the minds of customers and policy makers alike, have concentrated their retail banking operations on supporting three main customer segments: households,

1 Livret A deposits are the most common and traditional type of passbook savings account in France.

SMEs, and local authorities. In supporting these customer segments at a local level the savings banks sectors are reaffirming their commitment to regional development. In *Table 3.18* the customer lending market share of savings banks is presented for the period 1984–1997. The importance of savings banks as a source of credit is particularly pronounced in Spain (40.1 percent), Germany (35.5 percent), Portugal (37.4 percent), Sweden (66.4 percent), Austria (32.5 percent) and Norway (30.1 percent). The savings banks sectors of France, Spain and Sweden have increased their customer lending market shares by a considerable margin since 1984. The Italian and Belgian savings banks sectors have maintained a relatively constant market share over the period of around 20 percent of customer loans. Again, the restructuring of the Danish and Finnish savings banks sectors has meant that market shares have collapsed since 1992–1994; by 1996 both sectors owned less than 10 percent of banking loans.

Savings Banks Market Share of Banking System Lending (1984–1997) (%)

Country	1984	1989	1992	1994	1996	1997
Austria	25.3	24.6	31.4	31.7	30.7	32.5
Belgium	26.2	18.6	20.9	27.3	21.3	24.9
Denmark	28.9	29.7	18.1	17.1	7.3	–
Finland	19.6	18.9	15.9	7.5	5.5	–
France	–	4.0	4.3	5.2	5.3	5.8
Germany – *Sparkassen*	31.1	29.2	26.4	27.2	22.4	21.5
Germany – *Landesbanken*	22.4	18.4	20.2	21.0	15.2	14.0
Italy	20.7	21.2	20.5	21.1	18.1	19.2
Netherlands	7.0	4.6	3.5	4.2	5.3	4.5
Norway	20.1	24.3	25.0	26.6	29.4	30.1
Portugal	20.6	36.6	27.9	32.2	26.3	37.4
Spain	25.4	33.8	35.5	36.4	39.2	40.1
Sweden	22.9	21.1	23.8	36.0	34.0	66.4
UK – *Savings Banks*	–	1.6	1.6	1.8	1.6	0.7
UK – *Building Societies*	–	16.4	19.3	21.5	17.5	5.8

Source: Association Belge des Banques (1998, 1996); Banca d'Italia (1998, 1996); Banco de Portugal (1993, 1995–1997); Bank of England (1998); Bank of Finland (1998); Bank of Spain (1998); British Bankers' Association (1995–1997); Banque de France – CECEI (1996, 1990); Banque de France (1998–1999); BIS (1998); Building Societies Association (1990–1997); Building Societies Commission (1995/96–1997/98); CECA (1990–1997); Danish Securities Council (1990–1997); Deutsche Bundesbank (1997–1998); De Nederlandsche Bank (1990, 1993, 1996–1997); ESBG (1994–1997); EUFI Journal (various); European Central Bank (1999); Finnish Bankers' Association (1995–1997); Nordiska Bankmannaunionen (1997); Norges Bank (1997, 1995, 1993,1990, 1985); OECD (1996, 1994, 1991); Oesterreichische Nationalbank (1990, 1998–1999); Sveriges Riksbank (1998)

Table 3.18

Concentration and Average Size of Savings Banks

This section examines the levels of concentration found in European savings banks sectors and the average size of savings banks. Concentration in each national savings banks sector is measured as the percentage of sector assets, deposits and lending that is accounted for by: the leading domestic savings bank (1-firm); the largest three savings banks (3-firm); and, the largest five savings banks (5-firm). Average size is calculated simply as the total assets of a savings banks sector divided by the number of savings banks in that particular sector. Concentration ratios are shown in *Table 3.19.*

European savings banks sectors tend to have one leading savings bank: the median level of 1-firm assets concentration being 37.9 percent; deposits, 39.6 percent; and lending, 42 percent. In four savings banks sectors the 1-firm concentration level is greater than 50 percent: in Denmark, the Netherlands, Portugal and Sweden; both Austria and Finland record 1-firm concentration between 40–45 percent. Two of the five sectors have been restructured (Finland and Sweden), which helps explain the relatively high levels of concentration found in 1997. The Netherlands savings banks sector has also been rationalised through merger activity whilst the Portuguese sector is dominated, in terms of size, by Caixa Geral de Depòsitos. In comparison the least concentrated, or more

Concentration Levels in Savings Banks Sectors (1996–1997) (%)

Country	Assets			Deposits			Lending		
	1-firm	*3-firm*	*5-firm*	*1-firm*	*3-firm*	*5-firm*	*1-firm*	*3-firm*	*5-firm*
Austria	40.2	70.1	77.1	42.2	65.6	75.3	41.8	70.5	78.4
Belgium	34.2	80.8	89.9	38.1	75.8	87.0	43.0	83.4	92.1
Denmark	68.5	81.6	83.9	82.8	94.6	96.5	58.0	75.6	80.8
Finland	43.3	–	–	41.0	–	–	42.2	–	–
France	9.4	22.3	31.3	10.6	23.1	32.7	8.9	22.2	31.6
Germany	3.0	7.4	10.3	2.8	6.7	9.4	3.0	7.8	11.0
Italy	33.1	49.4	58.9	24.1	40.6	51.6	38.1	51.2	62.2
Netherlands	50.4	–	–	55.0	–	–	52.6	–	–
Norway	31.9	45.5	57.0	28.5	40.7	51.9	30.5	44.5	56.3
Portugal	80.4	97.7	–	80.8	98.2	–	70.1	97.3	–
Spain	35.5	36.7	41.9	19.6	36.5	45.4	17.2	36.0	45.1
Sweden	68.8	–	–	52.0	–	–	51.9	–	–
UK – *Savings Banks*	100.0	–	–	100.0	–	–	100.0	–	–
UK - *Building Societies*	30.5	54.0	65.8	29.8	51.7	62.8	31.1	54.7	66.7

Source: Informe Mensual (1997); BankScope (1999); ESBG (1996–1997); Norwegian Savings Banks Association (1997); Deutsche Bundesbank (1998); Building Societies Association (1997); Danish Supervisory Authority (1997); CENCEP (1997); CECA (1997)

Table 3.19

fragmented, savings banks sectors were to be found in Germany, France and Spain, which are three of the largest savings banks sectors in Europe. The German, French and Spanish savings banks sectors adhere to the territorial or regional principle; that is the savings banks' business activities are restricted to their localities or regions.[2]

Germany is by far the least concentrated savings banks sector under review. Its 5-firm assets concentration ratio of 10.3 percent is three times lower than the French savings banks' (31.3 percent). In Spain and Italy, which are both large savings banks sectors in terms of balance sheet volume, the five leading savings banks account for 41.9 percent and 58.9 percent, respectively. This means that, in Spain, about 50 and, in Italy, 70 other savings banks have a market share of nearly 60 percent and just over 40 percent of assets. The most concentrated savings banks sectors (measured by the 5-firm assets ratio) are to be found in Belgium (89.9 percent), Denmark (83.9 percent), Austria (77.1 percent) and the UK building societies (65.8 percent).

Table 3.19 shows that the levels of customer deposits concentration are generally slightly lower than for total assets, although the trends are of the same direction. This implies that customer deposits are more evenly spread across savings banks, something that can be attributed, in part, to geography. Lending concentration is generally higher than customer deposits concentration at the 3-firm and 5-firm levels. One possible explanation is that customer deposits collection via the branch networks is more evenly distributed because of geography, while the demand for customer lending may be more concentrated due to population density differences and the urban-rural divide.

The average real size of savings banks increased for the majority of sectors between 1984 and 1997 (with the exception of the Danish and Finnish savings banks sectors) as shown in *Table 3.20*. Increased concentration arose through greater consolidation, which is achieved through restructuring the sector, natural attrition or merger activity. There is evidence of how both features can impact on bank size. First, in sectors that have been extensively restructured there is a marked change in the average real total assets per bank: for example, between 1994 and 1997, and 1992 and 1994, there were substantial decreases in real assets per bank in Denmark and Finland; between 1989 and 1992 the real assets per bank increased from ECU871 million to ECU4,232 million for the reconfigured French savings banks sector. Second, there has been natural attrition, which has increased the average real assets per bank in a number of savings banks sectors such as in Spain where the average real assets per savings bank has risen from ECU1,489 million in 1984 to ECU5,372 million in 1997.

The effects of increased concentration over time can also be seen in *Table 3.20*. The commentary excludes the large, wholesale business orientated German *Landesbanken* although *Table 4.20* does show their average size for information purposes. The largest (average) savings banks as at 1997 are found in Belgium (ECU9,075 million), Portugal (ECU8,539 million), France (ECU 5,699 million), Spain (ECU5,372 million) and the Netherlands (ECU4,658 million). In contrast, the smallest savings banks are characterised by their regional proximity; these are the four Scandinavian savings banks sectors: Denmark (ECU89 million), Finland (ECU113 million), Norway (ECU328 million) and Sweden (ECU945 million).

2 In both France and Germany there are legal restrictions which stipulate that savings banks must operate within their designated locality or region. This restriction has been revoked in Spain. Yet, despite this there is evidence that only the largest Spanish savings banks have expanded into new territories.

Average Total Assets Size of European Savings Banks (1984–1997) (ECU, mn, 1996 prices)

Country	1984	1989	1992	1994	1996	1997
Austria	584.5	733.6	1,133.0	1,585.0	1,759.5	1,871.3
Belgium	2,482.9	3,394.7	4,204.2	4,109.2	–	9,075.0
Denmark	179.5	337.6	189.7	187.8	91.7	88.9
Finland	47.1	139.8	549.2	195.6	102.3	113.4
France	308.5	870.8	4,232.1	4,529.5	5,272.4	5,699.4
Germany – *Sparkassen*	870.9	1,006.1	1,123.3	1,161.4	1,349.5	1,426.6
Germany - *Landesbanken*	31,667.8	42,440.3	50,794.5	57,339.7	60,003.2	64,824.9
Italy	2,342.2	3,139.6	3,328.0	3,656.7	3,687.6	3,779.4
Netherlands	239.5	390.6	547.1	919.5	4,657.7	–
Norway	89.9	233.8	243.9	260.9	298.1	327.5
Portugal	1,205.8	2,715.3	–	4,247.0	9,310.4	8,538.9
Spain	1,489.0	2,422.1	3,991.4	4,724.2	5,185.9	5,371.5
Sweden	189.4	330.6	476.4	464.4	691.1	945.1
UK – *Building Societies*	–	2,659.7	3,795.7	4,377.7	4,348.1	2,485.7

Source: OECD (1996, 1994, 1991); EUFI Journal (various); ESBG (1994–1997); Building Societies Association (1990–1997); BankScope (1999); Deutsche Bundesbank (1998, 1997); CECA (1990–1997); CENCEP (1994–1997); Finnish Bankers' Association (1995–1997); Norwegian Savings Banks Association (1997, 1996, 1995b, 1994a); Danish Securities Council (1990–1997)

Table 3.20

A caveat to the analysis should be noted. In savings banks sectors, where there is a large bank and where the 1-firm concentration level is relatively high, the average size of banks will tend to be in excess of the median. One such example is Portugal, which has the second-largest average total assets (ECU8,539 million), yet the 1-firm assets concentration ratio is around 80 percent.

Table 3.21 examines the coverage and productivity of European savings banks sectors. The coverage data are defined as the total assets, customer deposits and customer lending of each savings banks sector denominated by the number of branches. For productivity the denominator is the number of employees. Although these estimates are crude (and should not be taken in isolation) they do provide some useful information. In terms of real total assets per branch the median figure for European savings banks was ECU46 million. For example, the Spanish banking system is considered over branched, a feature that is reflected in the fact that the real assets per branch of the savings banks was ECU16.5 million in 1997. While there may be a case to answer regarding over-branching, there is another issue to consider. By utilising the extensive branch network (of 16,653 branches in 1997, see *Table 3.2*) the Spanish savings banks have adopted a strategy of providing many outlets to reach their target customer segments. At the same time, savings banks compete with the commercial banks, which typically have a greater presence in urban areas.

Coverage and Productivity of Savings Banks Sectors (1997) (ECU, mn, 1996 prices)

Country	Branch			Employee		
	Assets	Deposits	Lending	Assets	Deposits	Lending
Austria	90.6	38.0	44.7	5.4	2.3	2.7
Belgium	76.9	49.0	27.9	16.4	10.5	6.0
Denmark	26.3	17.8	14.3	2.3	1.6	1.3
Finland	18.5	14.9	10.9	2.6	2.1	1.5
France	46.1	47.9	14.2	4.9	5.1	1.5
Germany – *Sparkassen*	45.4	29.7	27.1	2.2	1.5	1.3
Germany - *Landesbanken*	1,969.0	362.3	775.8	46.2	10.0	20.0
Italy	40.0	18.8	18.1	3.2	1.5	1.5
Netherlands	51.3	21.5	42.5	5.2	2.2	4.3
Norway	43.0	27.6	36.5	4.2	2.7	3.6
Portugal	47.9	34.7	23.6	2.9	2.1	1.4
Spain	16.5	13.0	8.6	3.0	2.4	1.6
Sweden	60.8	22.6	44.9	5.4	2.0	4.0
UK – *Savings Banks*	12.5	7.9	8.3	0.5	0.3	0.3
UK – *Building Societies*	68.6	48.0	56.1	5.0	3.5	4.1

Source: BankScope (1999); Bank of England (1997–1998); British Bankers' Association (1998); Building Societies Association (1997); Building Societies Commission (1997/1998); Danish Securities Council (1990–1997); ESBG (1996–1997); Deutsche Bundesbank (1998); Germany Savings Banks and Giro Association (1996); Informe Mensual (1997)

Table 3.21

The median real customer deposits and customer lending per branch were ECU27.6 million and ECU27.1 million, respectively, as at 1997. Those savings banks sectors whose branches administered the largest volumes of customer deposits and customer lending were to be found in Austria, the Netherlands, Sweden and the UK building societies, together with the German *Landesbanken*.

The productivity measures show that (with the exception of the German *Landesbanken*) the Belgian savings banks were by far the most productive, with total assets per employee of ECU16.4 million in 1997. This amount was far in excess of the median level of productivity of ECU4.2 million. Other relatively productive sectors include the Austrian savings banks (ECU5.4 million), the Swedish savings banks (ECU5.4 million) and the UK building societies (ECU5 million). By contrast, the least productive sectors were to be found in the UK savings bank (ECU0.5 million), and the German *Sparkassen* and Danish savings banks (ECU2.2 and 2.3 million, respectively).

Analysis of Savings Banks' Lending by Customer Group (1984-1997)

The underlying customer lending strategy of the European savings banks has been based on the provision of credit to three main customer segments: households, companies (including SMEs) and local authorities. As local or regional bankers, the savings banks have acquired a considerable amount of knowledge about local markets. This fact should enable them to price their products more competitively than national banks that lack the detailed local knowledge. In this section the volume of real customer lending is broken down into four key customer segments/products: loans to individuals; mortgages; company loans; and loans to local authorities. The period of analysis is for select years between 1984 and 1997 (see *Table 3.22*).

In comparison with the 1994–1996 period, the most recent data, for 1996–1997, show that all but four of the sectors under review increased their real customer lending. The highest levels of growth were achieved by savings banks in the following countries: Spain (14.5 percent); Austria (14.2 percent); and Belgium (17.0 percent). Although the Swedish savings banks sector increased customer lending by over 25 percent, this performance includes the effects of the recent merger. Similarly, the decline in customer lending recorded by the UK savings bank was the result of the reorganisation within LloydsTSB. Of the larger savings banks sectors, only the German *Landesbanken* recorded a decline in customer lending.

It is worth noting from *Table 3.22* those the savings banks sectors that were reconfigured in the early-1990s returned customer lending growth across 1996 to 1997, for example, the Danish and Finnish savings banks sectors. While the data reflects the slow macro economic environment, which has been partly conditioned by the need to meet European Union convergence criteria, the growth in savings banks' real customer lending emphasises the sector's contribution to and key role within the European financial system.

By 1996–1997 mortgages accounted for the largest share of total customer lending for the majority of savings banks: France (48.3 percent), German *Sparkassen* (31.3 percent), Norway (63.5 percent), Portugal (48.5 percent) and Spain (52.8). The position of savings banks as bankers to local authorities is particularly marked in Germany and France and, to a lesser extent, in Austria. The German *Landesbanken* extended 31.6 percent of their customer lending to local authorities in 1997, while the French savings banks extended 30.1 percent and the Austrian savings banks 14.9 percent of customer lending, respectively, to local authorities.

In 1997 the provision of bank finance to companies (mainly SMEs) was the prime lending business of savings banks in Austrian (50 percent), Italy (62.7 percent) and Germany (*Landesbanken*, 41.4 percent and *Sparkassen*, 33 percent). Company loans are the second-most-important activity of six savings banks sectors: Belgium (20.7 percent), Finland (26 percent), Norway (26.1 percent), Portugal (40.9 percent), Spain (30.3 percent) and Sweden (40.9 percent). The volume of personal lending business is relatively less important to the majority of savings banks sectors. Exceptions, however, include the Finnish savings banks sector which advances 72 percent of customer lending to this segment, and Belgium for which the figure is 57.5 percent.

Trends in Savings Banks Sectors Customer Lending (1984–1997) (ECU, mn, real (1996) prices)

Country	*1984*	*1989*	*1992*	*1994*	*1996*	*1997*
Austria						
Customer Loans	29,509	37,646	54,242	55,638	57,403	65,582
Individuals (%)				18.6	17.4	17.1
Mortgages (%)				inc in ind[1]	inc in ind	inc in ind
Companies (%)				62.5	51.0	50.0
Local Authorities (%)				18.9	16.9	14.9
Belgium						
Customer Loans	26,698	33,767	40,848	48,127	50,676	59,299
Individuals (%)				57.9	57.9	–
Mortgages (%)	67.7	52.2		inc in ind	inc in ind	–
Companies (%)				22.8	20.7	–
Local Authorities (%)				19.3	21.8	–
Denmark						
Customer Loans	11,475	20,955	12,492	10,722	5,347	5,377
Individuals (%)						–
Mortgages (%)	14.9	8.7				–
Companies (%)						–
Local Authorities (%)						–
Finland						
Customer Loans	8,745	17,224	13,878	3,280	2,410	2,672
Individuals (%)				71.0	70.8	72.0
Mortgages (%)				inc in ind	inc in ind	inc in ind
Companies (%)				23.0	24.1	26.0
Local Authorities (%)				0.9	5.1	10.0
France						
Customer Loans	67,986	38,947	45,619	50,624	55,639	59,643
Individuals (%)	0.6	8.1	5.8	3.1	1.8	10.6
Mortgages (%)	36.1	69.2	56.7	52.4	50.9	48.3
Companies (%)	14.3	inc in ind	inc in ind	9.0	10.7	11.0
Local Authorities (%)	48.9	22.7	36.2	28.5	29.7	30.1

Table 3.22

Trends in Savings Banks Sectors Customer Lending (1984–1997) (ECU, mn, real (1996) prices)

Country	1984	1989	1992	1994	1996	1997
Germany – Sparkassen						
Customer Loans	305,222	346,928	397,015	464,402	497,224	508,791
Individuals (%)	22.0	24.8	26.2	14.8	14.0	31.4
Mortgages (%)	33.8	32.8	29.4	41.7	44.6	31.3
Companies (%)	31.3	32.4	36.8	36.3	35.2	33.0
Local Authorities (%)	12.9	9.8	7.6	6.6	6.2	4.3
Germany – Landesbanken						
Customer Loans	229,856	226,797	296,524	359,538	338,250	332,046
Individuals (%)	6.5	6.1	10.6	2.5	1.9	9.2
Mortgages (%)	22.3	22.8	19.2	21.9	22.1	17.8
Companies (%)	24.1	21.4	36.4	33.4	35.1	41.4
Local Authorities (%)	47.1	49.7	33.8	41.5	40.4	31.6
Italy						
Customer Loans	59,279	82,800	118,525	122,580	103,262	109,737
Individuals (%)	16.5	5.2	inc in cos[2]	7.7	10.3	–
Mortgages (%)	12.0	13.9	15.3	30.3	35.2	31.4
Companies (%)	71.5	80.6	84.7	62.0	54.5	62.7
Local Authorities (%)	inc in cos	inc in cos	inc in cos	inc in cos	inc in cos	–
Netherlands						
Customer Loans	10,333	12,296	11,772	17,430	20,513	12,876
Individuals (%)	2.3	3.5	inc in cos			–
Mortgages (%)	61.0	69.2	72.8			–
Companies (%)	17.4	17.5	17.1			–
Local Authorities (%)	19.3	9.9	10.1			–
Norway						
Customer Loans	13,607	27,159	26,749	28,513	33,571	36,933
Individuals (%)				11.6	8.8	–
Mortgages (%)				51.9	63.5	–
Companies (%)				34.5	26.1	37.1
Local Authorities (%)				2.0	1.5	–

Table 3.22 cont'd

Trends in Savings Banks Sectors Customer Lending (1984–1997) (ECU, mn, real (1996) prices)

Country	1984	1989	1992	1994	1996	1997
Portugal						
Customer Loans	9,842	13,271	13,089	14,461	21,678	21,052
Individuals (%)	inc in cos	inc in cos	0.4	inc in mort[3]	4.0	
Mortgages (%)	50.1	66.0	66.0	62.7	48.5	
Companies (%)	40.3	26.3	27.8	30.5	40.9	
Local Authorities (%)	9.6	7.7	5.8	6.8	6.6	
Spain						
Customer Loans	44,504	75,382	98,068	114,871	125,128	143,293
Individuals (%)	51.5	49.4	26.8	31.0	30.7	60.2
Mortgages (%)	42.3	43.8	46.8	52.3	52.8	–
Companies (%)	inc in ind	inc in ind	16.5	5.4	4.9	30.3
Local Authorities (%)	6.2	6.8	9.9	11.3	11.6	9.5
Sweden						
Customer Loans	16,886	26,239	27,873	22,270	49,850	62,760
Individuals (%)					30.6	49.2
Mortgages (%)					inc in ind	–
Companies (%)					67.5	40.9
Local Authorities (%)					1.9	3.9
UK – Savings Bank						
Customer Loans	14,180	26,547	25,078	26,393	27,134	11,379
Individuals (%)	22.9	15.4	26.2			
Mortgages (%)	28.2	69.4	57.4		47.1	
Companies (%)	9.5	14.8	16.4			
Local Authorities (%)	39.4	–	–			

Note: The data in the column headed 1994 are as at 1995.

Footnotes:
1. Inc in ind = Non-bank loans advanced as mortgages are aggregated into loans to individuals.
2. Inc in cos = Loans advanced to companies.
3. Inc in mort = Loans to individuals are aggregated into mortgages.

Source: ESBG (1994–1997); OECD (1996, 1994, 1991); BankScope (1999); EUFI Journal (various); Deutsche Bundesbank (1998, 1995); German Savings Bank and Giro Association (1995–1997)

Table 3.22 cont'd

One important feature that savings banks use to position themselves strategically in the minds of customers is their contribution to their localities or regions. An illustration of the contribution by savings banks to local economic and social development is the percentage of lending to companies and local authorities. In 1997 the German *Landesbanken* extended over 70 percent of customer lending to companies and local authorities. For the following savings banks sectors local development lending constitutes over half of customer lending: Sweden (54.8 percent), Austria (64.9 percent), and Italy (62.7 percent). The Belgian, French, and Portuguese savings banks sectors contribute 40–50 percent of lending to local development. The German *Sparkassen* generally contribute similar levels but in 1997 their contribution was 37.3 percent. In Spain, Norway and Finland the savings banks sectors specialised more in household finance (personal loans and mortgage lending).

Conclusion

The structure of the European savings banks industry has altered, quite significantly in some sectors, since the 1980s. Change, such as reduced numbers of savings banks and a mixed pattern of changes in branch networks, has been facilitated through restructuring and natural attrition. One of the drivers of structural change has been financial deregulation.

In this chapter several trends have been noted in this chapter on the evolving balance sheets of European savings banks sectors. An overall re-emphasis on core retail banking activities (lending and deposit taking) has occurred. However, in a number of savings banks sectors interbank business has increased quite significantly, with some savings banks sectors switching their funding arrangements to include a higher proportion of interbank deposits. Another development has been that savings banks sectors have improved their capital positions.

In the majority of the European countries under review, the savings banks sectors account for at least 20 percent of banking system assets. The comparative advantage of the savings banks industry would appear to lie in deposit market share. On the whole, savings banks sectors have increased their deposit market share.

The European savings banks sectors are highly concentrated. In the majority of sectors, the 1-firm concentration ratio is at least 20 percent. Fragmented savings banks sectors are found in Germany and, to a lesser extent, in France. In terms of assets size, the average savings bank has become noticeably larger reflecting inter alia strategies designed to realise sufficient critical mass, particularly with respect to capital.

Mortgages would appear to be the single most important customer product being offered by the European savings banks industry. Our analysis of savings banks sectors' lending portfolios does, however, draw a distinction between sectors that appear to focus on providing loans to companies and local authorities, and those concentrating on mortgages and loans to households.

4 Broad Strategic Developments in the European Savings Banks Industry

Introduction

The following country sections summarise selectively the broad strategies and strategic developments of some of the savings banks in each country, with a particular emphasis on universalisation (*Allfinanz* strategies), the customer base, SMEs and strategic alliances. In addition, key trends in domestic banking, which impact on the savings banks sectors, are identified.

Austria

The Development of the Banking Market in Austria

Austrian banking entities are operated on the universal banking principle, which allows all credit institutions, subject to banking law, to carry out all types of banking business. However, despite the existence of this common basic principle, banking groups in Austria have developed according to different tasks and functions. In addition to the large commercial banks (albeit quite a small number) and the savings banks group, with some 70 savings banks and at least 1,500 branches, the *Raiffeisen* banks, *Volksbanken* and the Postal Savings Bank are active in Austria.

The *Raiffeisen* group of banks, which is built on a three-tier system, comprises around 700 independent *Raiffeisen* banks with about 1,700 branches, and concentrates primarily on private customer business. In addition, at the level of the Austrian regions, or *Bundesländer*, there are nine regional *Raiffeisen Landesbanken*, which operate as clearing operations for the primary banks. The third level consists of the central bank of the *Raiffeisen* group, which concentrates primarily on large customers or wholesale banking. In total, the *Raiffeisen* sector has a market share of approximately 20 percent.

Another group of institutions is the Austrian *Volksbank* sector (public banking sector) which numbers fewer than 100 institutions and is built on a two-level system. At the top level is the Austrian Volksbank AG OWAG, which at the same time operates as a universal bank. In its function as the highest level institute of the *Volksbank* sector it provides the sector with various services. It secures liquidity exchange within the sector, operates payment systems and carries out the settlement of security business. As a universal bank it concentrates on the area of small and medium-sized enterprises as well as on private client business.

Lastly, a further significant player in the Austrian market is the Postal Savings Bank. This institute is currently established as an institute under public law, however, it will shortly change status to that of a joint stock company. The sphere of business activity of the Postal Savings Bank is restricted to Austria and is focused essentially on the areas of private customer business and payment systems. Due to continued restrictions on the public sector, the operations of the Postal Savings Bank are limited and it is not allowed to provide loans to private and business clients. However, it is active in these business areas through its subsidiary company, the Bank of the Austrian Postal Savings Bank AG (Bank der Österreichischen Postsparkasse AG).

Foreign-owned banks have only a small number of branches in Austria and, despite their presence in the market for a number of years, have attained only a very low market share. The activities of these banks are confined to a few specifically chosen products or market segments. Foreign-owned banks operating in Austria include: Société Général, ABN-AMRO, Deutsche Bank, Crédit Lyonnais, Citibank, Schoeller Bank, Bayerische Vereinsbank and the San Paolo Bank.

The Austrian Savings Banks Group

The savings banks group is the largest banking group in Austria. With a total balance sheet of approximately Sch1,850 billion (Austrian Schilling) at the end of 1997, the market share of the savings banks group as a percentage of the total Austrian banking market is approximately 33 percent (excluding Creditanstalt which since January 1997 has been part of the Bank Austria Group). At the core of this sector are the 71 savings banks, including the first and second largest banking groups in the country; Bank Austria and the Erste Bank der Österreichischen Sparkassen. (The Erste Bank der Österreichischen Sparkassen merged in October 1997 with GiroCredit). The savings banks sector operates a dense regional branch network of approximately 1,500 branches in all regions (*Bundesländern*). In addition, the savings banks group is represented in around 20 countries worldwide and in all large financial centres through their subsidiaries, representatives and branches and also through the savings banks co-operation network in all EU states.

In addition to the savings banks themselves, within the savings banks group there is also a range of partners which offer various *Allfinanz* services, including: the Savings Banks Insurance company, which is the largest Austrian life insurer; the Savings Banks Building society, which is the market leader in the Austrian building society sector; SparInvest Austria, which combined with three other investment fund operations of the group has approximately 150 funds; and Spardat, which is one of the largest Austrian Internet providers. The savings banks group is represented in leasing activities by large companies including IMMORENT, the Bank Austria Leasing Company and the Erste Leasing Company. This group has recently been joined by the United Pension Fund or Pensionskasse, which is active in the growing pensions market.

Legal Environment of Austrian Savings Banks

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NB!

The savings banks in Austria have private legal status and were set up either by municipalities or by savings banks associations. There are 45 municipal savings banks (Gemeindesparkassen) and 26 association savings banks (Vereinssparkassen). Of the 71 institutions, 22 are joint stock companies (*Sparkassen – Aktiengesellschaften*). When a savings bank creates a joint stock company, it transfers the banking activity to this company and from then on its function is limited to that of share management (Anteilverwaltungssparkasse).

The articles of association of savings banks state that they shall contribute in particular to the economic development of the population and private and public companies in their field of activity, by receiving deposits and providing means of financing and adequate banking services. Furthermore, savings banks are also responsible more specifically for providing financial advice to the population, especially to young people, SMEs and municipal authorities. By promoting the idea of saving, and by granting corresponding credit, savings banks consider that they have a duty to contribute to the growth of the local population's assets. Savings banks also support tasks of public, social or cultural interest in their area of activity.

All Austrian savings banks are universal banks, providing a wide range of financial products. With the exception of the two large savings banks based in Vienna, they are restricted from granting mortgage bonds and municipal bonds. Due to their size, the two major savings banks established in Vienna focus strongly on industry and the economy. The business focus of the regional savings banks mainly concerns private customers, industry, trade and the municipalities. Some institutions have holdings in banking-related areas such as leasing and investment transactions. The principle of geographic limits on savings banks activity was abolished in 1979.

Regarding merger activity, there has been no merger to date in which a savings bank has been taken over by an institution outside of the sector. However, institutions outside of the sector, notably large joint stock banks, have been taken over by institutions from within the savings banks sector. Mergers have occurred between neighbouring savings banks, between savings banks from the regional capitals or with one of the two major savings banks in Vienna.

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There is a special savings banks guarantee system in Austria. In the case of municipal savings banks, the municipality provides a performance guarantee for all the savings bank's commitments should it become insolvent. Association savings banks do not benefit from such a guarantee. Concerning savings banks' joint stock companies, the savings bank share management company guarantees the activity of the stock company and the municipality guarantees the activities of the savings bank share management company. Moreover, deposits are guaranteed with all savings banks by the savings banks guarantee company (S-Haftungs Aktiengesellschaft) of which all the institutions in the sector are members.

Structural Changes in Austrian Banking

Austria is one of the most over-banked and over-branched countries in Europe. During the past 20 years the number of independent financial institutions in Austria has reduced by more than 700 to today's levels of approximately 1,000 credit institutions. The number remains very high in comparison with other countries and can be traced back to the special organisational structure of the *Raiffeisen* sector. During the 1970s and beginning of the 1980s merger activity was characterised by combinations of small institutions in the *Raiffeisen* and *Volksbank* sectors. Thereafter, mergers occurred between large and small banks in the savings banks sector.

Concentration has now begun between the large banking players: merger and increased co-operation are a natural response to the expansion of the market. During the 1970s and 1980s there was a liberalisation of competition between economic entities at the service of local communities and municipalities within Austria. At the beginning of the 1990s this process was expanded to European level. However, the concentration process in the sector has since slowed somewhat. In the period 1977–1987 twice as many banks disappeared through merger as compared with the ten-year period to 1997. Structural change in the Austrian banking sector has been a long-term process.

Importantly, although a degree of consolidation has occurred, this has not lead to a parallel rationalisation of branch networks. In recent years determined efforts by banks to increase their market shares have lead to an extension of their branch networks. Even with the consolidation achieved so far the banking system remains fragmented. Nevertheless, the differences between the various types of bank have become less and less clear-cut as a result of competitive pressures. At the same time the savings banks continue to define themselves as being particularly close to their customers, as being regionally rooted and above all as being financial institutions that serve the needs of medium-sized enterprises.

Austria's banking environment is made up of a large number of small banks, a smaller number of medium-sized or large banks and no banks of international scale. Austria's biggest bank ranks only 115th in the world. More than half of Austrian banking deposits are held by the ten largest banks. This situation has resulted in an almost continuous process of concentration in Austrian banking over recent years. At European level the leading bank in each country has, on average, a market share of 21 percent. The market share of Bank Austria, the leading domestic bank is about 13 percent (without Creditanstalt).

Impact of the European Economic Area and European Union on Savings Banks' Strategies

In 1994 Austria became a member of the newly founded European Economic Area and January 1 1995 a member state of the European Union (EU). The rules which the Austrian financial services sector was subject to following membership of the EEA were essentially the same as those it was required to adhere to following its accession to the European Union.

European Union membership ushered in equal conditions for all credit institutions but it did not result in the promotion of a single banking model. The specific characteristics of the savings banks were maintained, as was pluralism within the sector. As a result of membership of the EEA and the EU, the principles of freedom of establishment and freedom to provide services were enshrined in Austrian banking law. However, experts consider that these principles will be used more by foreign entrants (such as non and near-banks) to the Austrian sector than by Austrian savings banks entering foreign markets. Despite Austria's membership of the European Union, the savings banks retain their regional focus through their continued commitment to their traditional markets and services.

Belgium

Three particularly important trends in the Belgian domestic banking sector are de-specialisation, concentration and internationalisation. These trends apply to all sectors; private, mutual and public banks. The public bank sector has historically been an important segment in the Belgian financial system. However, the position of the private banks has been eroded in several ways, including the increased penetration of the private banks into the social savings segment of the market, and the comparatively low profitability and solvency of the public banks. All public credit institutions have been, or are, waiting to be privatised. These trends signal the eventual demise of public banks in Belgium.

Universalisation is a strong trend in Belgium. In the retail sectors, investment savings and mortgage lending are perceived to be strong areas of future growth. The development of *Allfinanz* activities is seen as one of the important strategic areas that will shape the future of banking in Belgium.

Relatively strong securitisation trends in Belgium suggest that banks will increasingly target investment banking and fund management activities as well as specialist areas, like leasing. These trends also imply an increased strategic emphasis by the banks on relationship banking and the deployment of their credit management expertise in the middle and lower corporate lending market. Increasing securitisation may re-emphasise these latter sectors as both an opportunity (increased banking opportunities) and a threat (a growing adverse selection problem for banks). The larger savings banks and the IPCs (public credit institutions) are focusing their strategies more strongly towards larger enterprises; smaller savings banks in Belgium are now likely to concentrate on existing relationships.

In 1993 two of the largest savings banks in Belgium, CERA and BACOB, became commercial banks, as did the IPC, ASLK-CGER. This was partly in response to banking legislation (June 1991) designed to bring all banks in Belgium in line with EU rules. However, BACOB explained that the reason for the move was that the bank had already become, to all intents and purposes, a commercial bank. Within this general restructuring process the Belgian savings banks group agreed (in July 1994) to join the banks' association to form a single representative body. Strategically (and in common with most of Europe) the historical differences between private, public and savings banks in Belgium are increasingly seen as less relevant. NB!

There have been a number of developments at all levels in savings banks' strategies in Belgium. The Savings Bank of Flanders, for example, has developed a strategy that has moved the bank away from 'behavioural segmentation' to 'integrated segmentation' of its customer base. The latter approach combines bank internal data with external data – such as customers' income, savings capacity and short-term projects – in order to produce greater precision in the composition of customer groupings.

During 1996 the first major cross-country merger of entities of comparable size, structure and profitability took place. The entities involved were Crédit Communal de Belgique (CCB) of Belgium, the French bank Crédit Local de France, and Banque Internationale à Luxembourg, the Luxembourg-based subsidiary of CCB. The resulting bank is known as Dexia. Its activities focus on local authority financial services, international private banking, asset management and fund administration.

The Belgian banking system in 1999 is relatively competitive due, in part, to being over-banked. Margins in the retail and wholesale businesses have narrowed. The introduction of the single currency is expected to further raise levels of competition. These trends are likely to benefit the large Belgian banks, which have increased their market share in recent years at the expense of smaller, less profitable banks. The large banks have been able to realise increased market share due to the increasing importance of services and technology. The smaller banks are facing a more competitive environment.

Belgium banks have been clearing ECUs since the early 1980s. The opportunities for realising interest arbitrage will continue with the euro. Yet, the erosion of income on previously profitable foreign exchange operations can be expected to facilitate the introduction of bank charges and the raising of existing charges such as ATM transaction fees. The estimated information technology (IT) costs associated with the euro are around Bfr11 billion (275 million euros) for the domestic banking system.

France

The *caisses d'épargne* (the savings banks) emerged in France at the beginning of the 19th century with the sole objective of collecting the savings of private households; the financial management of the funds collected was entrusted to the Caisse de Dépôts et Consignations (CDC). An interesting method with which to chart the development of the savings banks is to consider the changes that have been and are occurring with respect to the liabilities and asset sides of the balance sheet, as well as the structural and organisational changes required by the diversification of savings banking.

The large number of savings banks, prior to consolidation, necessitated the creation of financial institutions that would be able to assume responsibility for financial transformation at a regional level. The size of the savings banks meant that they were unable properly to manage the flow of funds. As a result, regional savings organisations (GREP), were created in December 1969 by the savings banks and the CDC to monitor and control a part of the funds collected. In 1983 the GREP were themselves transformed into SOREFI (regional financing companies) which operated in the same way until they were abolished in July 1991.

The reorganisation and concentration of the savings banks sector became necessary because of the need for entities of sufficient size to develop new activities. This process rendered regional financial structures, such as SOREFI, redundant. Hence, the responsibility for asset and liability management passed back to new and larger savings banks, thereby giving them a regional dimension (see *Table 4.1*).

Evolutionary Path of French Savings Banks Sector – 1970 to Present

I) Diversification of deposit-taking products					
1978	*1980*	*1982*	*1983*	*1984*	*1990*
Current accounts	Life insurance products	People's savings deposits[1]	Special deposits for SME financing	Savings bank bonds	Long-term savings plan
II) Diversification of asset products					
1971	*1981*	*1987*			
Local authority loans by the SBs	Home improvement loans and consumer loans	Loans to SMEs			
III) Structures					
1970	*1983–1985*	*1987*	*1991*	*1995*	
Creation of regional financial entities owned jointly by CDC/SBs	1983 law CENCEP/ SOREFI	Financial decentralisation. Loans granted by SBs are no longer backed individually by SOREFI resources	Savings banks manage their balance sheets. Disappearance of SOREFI. Liquidity continues to be managed by CDC	Creation of a cental bank to manage liquidity in the network	

Footnote:
1. This product guarantees interest rate at least equal to national rate of inflation.

Source: Adapted from Perspectives, September 1 1995

Table 4.1

During the early 1980s CENCEP was created to regulate, orientate, organise, lead and control the entire savings banks group at the national level. The savings banks thus had a regulatory and organisational body that allowed them to establish a series of national specialised subsidiaries which generate large economies of scale due to the concentration of skills and development of sufficient critical mass. Some of these subsidiaries operate in diversified areas and include:

- A life insurance company;
- A management company for unit trusts and SICAVS[1];
- A guarantee company;
- Several inter-bank administrative structures; and
- A Central Bank of Savings Banks created in 1995 by the merging of two finance subsidiaries, Société d'Emission et de Crédit and Société Centrale de Trésorerie.

French savings banks have responded to the changes in their organisational structure by increasingly diversifying their activities, offering a whole range of banking and insurance products and services. *Table 4.1* shows how the product range of the sector has evolved since the 1970s. Retail banking remains the core activity of the savings banks despite legislative reform, which has facilitated product diversification into a number of other areas including the SME customer segment. A new customer segment emerged in 1990 when savings banks were allowed to offer long-term savings plans.

The Caisse d'Epargne drew up a strategic action plan in 1994. The main concerns of the group were to:

- Raise profitability;
- Increase productivity levels; and
- Establish a broader institutional presence.

Priority was given to organic growth around, with three key objectives:

- Developing competence:
  - Sustained development of human resource management and a compilation of a profile of job skills within the group;
  - Elaboration of a master training plan;
  - Implementation of new training and career planning programmes for upper-level managers.
- Increasing efficiency of information systems:
  - To converge and increase co-operation amongst the different EDP (electronic data processing) regions around two group-approved platforms;

1 Société d'Investissement à Capital Variable – SIVACs – are open-ended investment trusts.

- To establish a 'connectivity charter' to facilitate communications between the savings banks' EDP centres and the subsidiaries.

- Modernising the distribution network:

  - Continuation of branch office renovation programme (25 percent of premises over three years at a cost of Fr2 billion);
  - Expansion of sales-training to marketing staff;
  - development of new distribution channels complementing the retail network, including remote banking, telemarketing, rapid growth of Télécureuil and Phonécureuil connections and additional telemarketing platforms.

The strategic action plan reaffirmed the commitment of the savings banks group to branch banking. Branches were overhauled and changes made to the visual identity of savings banks. A more radical initiative has been the savings banks' shift away from a segmentation strategy, based on customer behaviour, to one of 'predictive' segmentation. As a result, the number of distinct products sold in each branch has been reduced from 120 to 33. The aim of this strategy is to increase both deposit and credit business. The group has experimented with 'discovery logic' as a theme for the layout of its branch at Amiens, which was opened in spring 1995. Discovery logic is a concept involving placing counters at the back of branches rather than near the entrance, thus ensuring that even cash customers receive some exposure to the bank's overall retail offer. The rationale is that customers first enter the branch and then decide what their needs are.

The savings banks have pursued a strategy of developing their services to public and private sector entities operating in local economies. The group is the second largest lender to French local and regional authorities and realised a 29 percent market share in 1996. The range of services has been extended in scope by the creation of the CCCEP, the central banking institution of the French savings banks sector. The widened range of services now available to the local authority customer segment includes large-scale project financing and the instigation of sophisticated financial transactions. Yet, competition in this customer segment has intensified with the entry into the market of German banks, which has served to drive down interest margins. In response to the new entrants, the French mutual banking groups have been utilising their comparative advantage as collectors of tax-advantaged savings products like the Livret A. The competitive situation has been further aggravated by a slow demand for loans from the French local authorities themselves.

A key feature of the French savings banks strategy relates to their international position. The Caisse d'Epargne continues to position itself as a European financial group. Some of its operational strategies have included:

- Co-operation between the savings banks of different European countries to work with EUFISERV[2] in an attempt to interconnect the entire European network;

- Targeting of packages of products and services aiming at facilitating cross-border real estate transactions (particularly, with Belgium and Germany); and

2 EUFISERV is an initiative of the European Savings Banks Group to develop and manage facilities in financial services, particularly in the area of payment services.

- The French savings banks (through the EUFIGEST group set up with savings banks of ten other countries) are preparing for the introduction of a single European currency by marketing three ECU-denominated UCITS.

During 1996 the French savings banks sector acknowledged that in order to consolidate their position within the domestic banking system and in order to further enhance themselves, the savings banks must consider the strategic option of acquisitions.

As part of this, the French savings banks group approached the government with a view to changing the legal status of savings banks to that of co-operative banks. The savings banks group considers that changing its status will enable the group to develop a framework that is compatible with the pressures facing modern banking systems. A change to co-operative status could be expected to consolidate customers' relationships with the savings banks through the possibility of shareholder-membership.

The French savings banks unveiled an institutional charter in 1996. The charter seeks to define the distinctive role of the group, which it claims sets the savings banks apart from other French banking groups.

The French banking system, like those of Belgium, Germany and Italy, is over-banked and over-branched. The five-firm assets concentration ratio for the French banking system (of 47 percent in 1996) showed the system to be relatively more fragmented than systems where increased consolidation has already taken place – for example in Sweden (86 percent) and in the Netherlands (81 percent). Nevertheless, the French banking system is less fragmented than that found in Germany (17 percent) and Italy (29 percent).

In the less-concentrated banking systems in Europe there is a need to improve both profitability and efficiency. A key and contentious issue relating to these twin goals is political and public willingness to accept reductions in bank staff numbers. While the French banking system has been characterised by strong resistance to such a reduction there have been signs that the situation may change. The December 1997 merger between SBC and UBS of Switzerland has signalled the return to importance of achieving critical mass. The prospect of the French banking system (along with other systems characterised by low retail banking profitability) becoming marginalised within Europe, as international investors seek investment opportunities, might have precipitated the change of heart over staffing levels. If domestic consolidation is allowed to increase and labour market reforms are forthcoming there is a belief that potential returns will be relatively high (Morgan Stanley Dean Witter, 1997). One possible consequence of increasing consolidation is the likely rise in the price of the stocks of smaller banks, which may become takeover candidates.

During 1996 the French banks began to estimate the likely costs of the single currency. *Table 4.2* shows the provisions made in 1996 by the French banking system.

While the French savings banks group made estimated provisions of Fr200 million (or ECU30.5 million), it should be explained that the largest savings bank, the Caisse d'Epargne d'Ile-de-France, did not make any such provision: instead, the bank has taken on extra staff to cope with the conversion.

The Banque de France has stipulated two means for banks to constitute their euro provisions. First, banks may spread provisions (up to a certain limit) across

Provisions for the Euro: French Banks and Banking Groups (ECU, mn)	
Bank or Group	***Provisions for Euro***
Banque Nationale de Paris	91.6
Savings Banks Group	30.5
Crédity Agricole Group	92.3
Crédit Commercial de France	23.7
Groupe CIC	18.3
Crédit Lyonnais	30.5
BFCE – Crédit National	0
Crédit du Nord	7.6
Crédit Mutuel Group	0
Banque Hervet	8.4
Banques Populaires Group	22.9
Paribas Group:	34.3
of which: Compagnie Bancaire	7.6
Société Générale	76.3
Banque Sofinco	3.1
Source: European Banker	

Table 4.2

a maximum five year period. This strategy has been adopted by BNP and the Crédit Agricole Group. The large French banks have estimated that total euro-related costs will lie in the region of Fr1.5–2 billion (ECU200–300 million). Second, provisions can be made a *posteriori*, ie after the costs have been incurred.

French retail banks, including the savings banks, have come under increasing threat from non-bank competitors such as retailer stores. During the 1980s retailers entered the retail banking sector through issuing private label cards which offered both revolving credit and debit facilities. In 1997 the retailers entered the savings and insurance markets. The move came as retail stores formed strategic alliances with specialist non-branch banks like Cetelem and Cofinoga, which hold the banking licences that are necessary for operating within the French payments system.

Traditionally, retail banking in France was split between the non-branch specialist banks, whose expertise lay in activities such as credit scoring, and the branch banks. The non-branch banks have concentrated on links with retail stores, car manufacturers and service providers while the branch banks have prioritised building their traditional consumer credit business (often using the specialist non-branch banks in the process). The retail firms and service providers have been developing their consumer credit business by creating financial services companies whose market share has increased to around 50 percent, despite the competitive efforts of the branch banks.

Although retailers have entered the savings and insurance markets, their activities in these areas are secondary to their core retailing business. Up to now, the retailers have simply sought to develop customer loyalty through the provision of financial services. One advantage they hold over branch banks is the high level of through-traffic and their longer opening hours. By 1998 the retailers were faced with a strategic decision. Either they remain focused on their core business and use financial services as a means of building customer loyalty, or they further develop their financial service activities. Adopting the second strategic alternative will make it likely that the target market segments will be traditional retail banking segments such as mortgage provision and medium to long-term savings products.

Another threat to traditional retail banks is direct banking. To date, the non-branch banks have met with mixed success with this type of service. While the French savings banks are committed to branching, some individual savings banks have embraced the concept. A branch-less bank was opened in September 1994 by Caisse d'Epargne d'Ile-de-France, France's largest savings bank with 3.2 million customers in the Paris region. The decision to create a direct bank was dictated by the fact that Caisse d'Epargne d'Ile-de-France carries out the classical functions of a commercial bank while, at the same time, fulfilling the social functions of a savings bank by catering for all sections of the community. Having a diverse and larger customer base meant that queuing time had increased, something customers found unacceptable. Caisse d'Epargne d'Ile-de-France introduced direct banking in the belief that financial services by telephone would interest up to 10 percent of customers. Other savings banks are thought to be considering establishing a direct banking presence.

Germany

The German savings banks sector is a three-tiered federal structure headed by the Deutscher Sparkassen und Giroverband (DSGV), the German savings banks and giro association. The second tier consists the *Landesbanken*, the regional banking institutions that are jointly owned by their respective Länder and the regional savings banks associations. Both the *Landesbanken* and their associations are members of the DSGV. The third tier is made up of the *Sparkassen*, the local savings banks, which are members of regional Sparkassen- und Giroverbände (Savings Banks and Giro Association); all regional savings banks associations are required to be members of the DSGV.

The savings banks financial group is the largest group in the German banking system. The *Sparkassen* or local savings banks are a major and formidable force in German banking. Their market share by segment (in 1996) was made up as follows: business volume, 37.7 percent; and lending to non-banks, 36.5 percent; municipal lending, 62.1 percent; non-bank deposits, 40 percent; eurocheque cards, 51.5 percent. The success of the German *Sparkassen* is attributable in part to their communal philosophy. They have also proved more resilient during recession than many other kinds of bank, mainly because of their detailed knowledge of local (regional) conditions.

The German banking system is generally regarded as inefficient by world standards. The major German banks, especially the three Frankfurt-based banks, are considered to have inefficient branch networks. It is estimated that the domestic cost-income ratios of the three Frankfurt banks averaged 71 percent in 1997; this is high by international standards. German banks will have to concentrate on cost control if they wish to improve their earnings performance with GDP growth of 2.83 percent being the lowest of the EU countries in 1997.[3] The poor bank revenue environment reflects weaknesses in most of the banks' major operating businesses. The banks experienced credit quality problems throughout the 1990s. Staffing levels at the major banks such as Deutsche Bank and Dresdner Bank have increased in the mid-to-late 1990s.

The key opportunities for German banks include:

- Improving efficiency in their domestic banking operations and branch networks;
- Using technology and new products to gain market share in a highly fragmented market;
- Taking advantage of changing customer demographics;
- Realising returns on investments made in the former East Germany;
- Increased disclosure to recognise the serving of shareholder needs; and
- Selling off industrial stakes in order to create and re-deploy capital.

Against this brief background some specific areas of interest may be explored. The first is universalisation or *Allfinanz*. This has been a traditional feature of German banking, with universal banks dominating the German banking market. However, the German universal bank system is differentiated from the European norm by the large number of different banking groups within it. In 1997, for example, over 3,400 different credit institutions operated via 43,430 branches. As a result, there is a high degree of deposit and credit market fragmentation.

Reflecting their communal philosophy, the larger institutions supplement the product ranges of the smaller *Sparkassen*. As a result, even the smallest *Sparkassen* are able to offer a wide range of financial services, which include mortgage loans, life and non-life insurance policies and an extensive array of retail products. The *Sparkassen* also act as 'local universal banks' to local corporate customers in their provision of commercial and investment banking products.

Increased competition in retail banking markets has narrowed interest margins, while greater customer sophistication has prompted banks to broaden their product ranges. In short, non-interest earnings have become a more important source of bank income. Banks will be targeting low-volume, high-margin business and greater selectivity in the range of banks' product offerings. German bankers expect a considerable growth in derivative products (equity, interest rate and foreign exchange derivatives) in the future. Leasing and project finance are also viewed as profitable opportunities. The number of securitisation transactions is expected to increase, especially in lease receivables, commercial loans, commercial mortgages and credit card receivables.

The German savings banks have traditionally been an important source of capital to SMEs. From the end of the 1960s, they have helped to finance SMEs

3 European Central Bank, 1999.

by taking shareholdings. Nevertheless, the savings banks' share of the total shareholding financing of SMEs has remained constant at around 14 percent. This market share is in stark contrast to the high penetration of the savings banks in other domestic segments of the SME market:

> "...75 percent of all small and medium-sized companies maintained commercial relations with savings banks, [German savings banks] share of the loan market reached nearly 40 percent and one new company formation out of two was financed by the savings banks."[4]

Although the savings banks dominate the domestic SME customer segment, the same is not true for the international segment of this market. At the same time, German SMEs are becoming more active internationally; the Single Market Programme (SMP) and the opening up of Eastern Europe are accelerating these trends. As a result, the DSGV developed a sales promotion strategy to intensify savings bank activity in this increasingly important segment of the market.

A current trend that bears on the universal bank strategy in Germany is a long-term erosion of banks core franchise in corporate lending. During the late 1980s the *Hausbank* principle began to be eroded at the top end of the corporate market as companies sought the best competitive terms from a wide range of banks (rather than just relying on the company's *Hausbank*) and competing capital market products. This reduction in the importance of the *Hausbank* now appears to be moving down to the *Mittelstand*, the German middle market, a sector that has traditionally maintained very strong relationships with the banking industry.

As a result, the major German banks have acquired investment banking capabilities; while other large German banks have entered into merger agreements with one another to create institutions that can compete effectively in the pan-European market. At the same time, this is likely to reinforce banks' strategic emphasis on smaller companies and specialist corporate products. The big German banks are also introducing new products and delivery channels into the retail market. This strategy by the large universal banks is intended to capture market share from the public sector institutions and the small co-operative banks.

The increasing sophistication of the customer base has been important in German bank strategies. German customers appear to be especially responsive to price incentives. One result of the changing customer demographics of an ageing population is that large amounts of assets (financial and other) will be transferred via inheritance during the next several years. Many banks are actively attempting to increase their share under management of such assets. The banks are benefitting from growing customer interest in equities, bonds and mutual funds.

The weakest element of the *Sparkassen* product offerings has been in investment advice and asset management. The response of the *Sparkassen* was to create a two-tier branch system. Ordinary business is transacted at the branches. Specialist advisory centres, with skilled staff, focus on those services needing more staff support. The *Sparkassen* also intensified their efforts to establish links with savings banks' networks in France, Italy, Spain and the Benelux countries. One of many agreements that link savings banks in Europe is that between the

4 Kohler, Peter, "German Savings Bank Organisation's 25 years of Shareholding Activity", *EUFI Journal*, October 1994.

German and French associations of savings banks, the DSGV and the CENCEP. Within this agreement, the Languedoc-Roussillon Savings Bank developed a scheme to allow German savings bank customers to complete a property project in its French region.

Despite the consolidation trends within German banking it remains the most fragmented and inefficient banking system by the standards of many other European and US banks. A trend of 'friendly' mergers between smaller and medium-sized co-operative and savings banks has increased the critical mass and efficiency of these banks. This, in turn, has posed an increasing competitive threat to the large supra-regional quoted banks, Bayerische Hypotheken und-Weschel Bank and Bayerische Vereinsbank, and the three *Großbanken*, (Deutsche Bank, Dresdner Bank and Commerzbank).

> "The increased average size of the savings and co-operative banks, in combination with their combined dominant market share of the overall German banking system, and the increased sophistication of their corporate client base, has resulted in a broadening of the activities of these companies, into the investment banking, securities issuance, forex and fund management arenas, encroaching upon the activities of the 'Grossbanken' who have traditionally enjoyed a dominant domestic market share of these markets."[5]

Nevertheless, the operating structures and general efficiency of the Savings, Giro and Co-operative banks are still inferior to the *Großbanken* and the larger regional banks. It is expected that further consolidations and mergers will help close these 'efficiency gaps'.

The savings banks group has responded in many other ways to the growing competitive threat and changing market environment. Up until 1993, for example, their respective (regional) *Landesbanken* represented most of the *Sparkassen* on the stock exchange. Some of the larger *Sparkassen* have now sought listings in their own names. The principle of savings banks operating only in their own regions has advantages and corresponding disadvantages. For example, because of the regional principle, only the 'free' *Sparkassen* (in 1998 there were seven, including the largest by total assets – Hamburger Sparkasse) can follow capital moving out of Germany.

Direct banking has been another competitive threat to the *Sparkassen*. The regional organisations have been quicker to act than the national DSGV. In 1996 the Bavarian savings banks association introduced a direct banking service in which all the region's savings banks participate. Lack of centralisation is one of the strategic disadvantages of the savings banks, which they are now seeking to overcome in various ways.

During 1996 and 1997 the five largest German banks (Deutsche, Dresdner, Commerz, Vereinsbank and Hypo Bank) acquired increased market share at the expense of other banking groups. The trend is expected to continue while the large banks enjoy competitive advantages over the *Sparkassen* and co-operative banks. The advantages include relatively low cost distribution networks; economies of scale; and strong penetration in attractive market segments such as investment and private banking.

5 Broughton, Alan, *The German Banking System*, European Bank Research, London, SBC Warburg, January 1996.

In July 1997 at the Amsterdam EU summit it was declared that the German savings banks would maintain their public sector status. The declaration emphasised the duty of the savings banks sector to their public sector owners. Both the *Landesbanken* and *Sparkassen* have gradually reduced the volume of business conducted with this customer segment, or at least increased the price of such business. Despite the declaration, the German private sector banks remain committed to their view that the savings banks sector should forgo its public sector guarantee in return for market independence.

In 1995 ratings agency Moody's awarded the *Landesbanken* ratings that disregarded their public sector guarantee. During early-1997 the *Landesbanken* attempted to modernise their corporate business by offering capital markets financing rather than bank lending to customers. As a part of this strategy the *Landesbanken* have invested heavily in capital markets expertise and begun a programme that aims to persuade retail customers and institutional investors of the benefits of equity and bond market products. The *Sparkassen* have followed suit with initiatives in the field of direct banking and the exploitation of their considerable resources such as the extensive ATM network.

The German banking system is characterised by a degree of excess capacity. Consolidation increased in 1998 and is expected to continue to increase over 1999–2000, despite the fact that banking groups such as the savings banks and co-operative banks own the majority of assets and branches. The fact that public sector ownership does not deter bank consolidation is exemplified by the February, 1998 merger of three public sector banks: Südwestdeutsche Landesbank, Landeskreditbank Baden-Württemberg (L-Bank) and Landesgirokasse Stuttgart (LG Bank). The combined assets of the new institution, Landesbank Baden-Württemberg (LBW), which were around DM430 billion, made this bank the sixth largest in Germany and the second-largest public sector bank behind West LB. The activities of LBW will include being banker to the state bank and retail banking through the 82 local *Sparkassen*.

The consolidation process between public sector banks could further increase, although merger talks between Nord LB and BankGesellschaft Berlin, which began in May 1997, led to a postponement of the deal in November 1998. There are plans in the region of Saxony to unite the 23 savings banks, the Landesbank of Saxony and the Saxon Construction Bank in a publicly-regulated holding company under the name 'SachsenBank'; the aim is to increase the efficiency and unity of the Saxon savings banks sector and remove certain market deficits which have existed up until now. However, the proposed creation of a holding has met with some rejection within the savings banks sector itself. In the opinion of certain savings banks representatives, the creation of a holding could result in the reduction of client and market proximity, could result in an impingement of the independence and flexibility of the savings banks in local areas and negatively affect the facility for interaction in local and community policies.

Furthermore, the new holding might not resolve the central structural problems of the Saxon savings banks organisation. With a combined balance sheet total of DM120 billion, the holding group would only reach the size of a medium-sized regional bank. Moreover, it is considered that in the long-term, the problems of the sector and specifically the *Landesbanken* could only be resolved through a countrywide restructuring or 'new order' of the German *Landesbanken*.

The *Sparkassen* deal with some 70 percent of the German population. With this in mind, in the spring of 1995 the *Sparkassen* began their preparations for the introduction of the euro. Information technology costs were expected to constitute 40–50 percent of the costs of EMU for the *Sparkassen*.

The savings banks group placed great emphasis on the need to provide information and consultancy services for individuals, companies and municipalities. Information concerning practical aspects of the conversion to the euro was also provided, for example, information about payment transactions in euro. A new system operating both in Deutschemark and euro commenced on January 1 1999; from that date the *Sparkassen* and *Landesbanken* offered all products and services in both currencies.

The *Sparkassen* are working on a three-pillar system for the distribution of products and services. First, all basic standard products are distributed through the branch network. Second, specialist centres deal with advisory and high-value investment business. Third, direct banking facilities such as telephone and PC banking are providing customers with greater freedom of access. Some 80 percent of customers were able to use direct banking in 1997. Although usage of direct banking in Germany is less than expected (around 4 percent utilisation in 1997), the *Sparkassen* held a 50 percent share of the market in PC banking in 1997.

Italy

The Italian banking system as a whole was propelled by legislative and regulatory changes to revise its structures and to modify the mix of its operations in what may be defined as a defensive strategy, typical of a difficult phase of transition. Although it is too early to identify any long-term effects, some noticeable short-term effects are shaping the strategies of Italian savings banks. The recent changes have led to important alterations in the way banking groups are formed around large banks. A large institution becomes an axis to which smaller banks are connected by alliances, or by the large bank takes equity stakes in the smaller banks. In some instances the small banks becoming wholly-owned subsidiaries of the large bank.

The major player of the Italian savings banks movement was Cariplo – the largest savings bank, with a customer base of 2 million. Cariplo's enlarged its influence across central and southern Italy by acquiring minority stakes in former savings banks, to which its supplied managerial and technical assistance. Typically, Cariplo took equity stakes of 20–50 percent. The recipient banks were usually required to distribute Cariplo's products as part of the agreement, with the smaller institutions benefiting from the capital injection from the larger bank. Smaller banks actively sought capital injections from large banks as part of a defensive strategy to maintain their local status and identity, and at the same time protect them from larger competitors.

In July 1997 Cariplo was acquired by Banco Ambrosiano Veneto (Ambroveneto). A new bank holding company, Bank Intesa, became operational in January 1998. The merger between Cariplo and Ambroveneto is part of the consolidation process that is taking place in the Italian banking system. In comparison with the pan-European trend towards greater consolidation, the Italian merger can be described as intra-country, non-overlapping, and critical mass driven. Ambroveneto is based in the north-east of Italy, while the strength of Cariplo lay in Lombardy and the centre-south. The merger has therefore consolidated both product and geography.

The combined assets of Ambroveneto and Cariplo made the new bank the largest Italian bank in 1998. It is now placed fourth-largest, by market capitalisation. The merger was inspired by defensive considerations and the desire to broaden the spread of financial services products within the combined grouping. Given that the amount of geographical overlap between the two banks is minimal there are unlikely to be major cost savings in the medium-term.

At the time of the merger the new bank had the largest branch network in Italy – 2,062 branches (as at December 1996). The two networks operate as independently-branded and marketed entities, while some centralisation in terms of IT and various support facilities has taken place. This is expected to realise cost savings of around 4.5 percent per annum, starting in 1999. Compulsory redundancies are not allowed in the Italian banking system. It is uncertain to what extent the merger will affect Cariplo's relationship with smaller savings banks. It is known that the Cariplo foundation will retain a shareholding in Bank Intesa of around 22 percent.

In the north-east of Italy, the creation of Unicredito in December 1994, as a holding company for Cariverona and Cassamarca, represents an important step in the direction of further co-operation among the savings banks of the region and the establishment of a strong banking group.

Examples of Consolidation in the Italian Savings Banks Sector

Acquiring Bank	*Objective Bank*	*Date*	*Type of Deal*	*Comment*
Cassa di Risparmio di Roma (CariRo)	Banco di Santo Spirito & Banca di Roma	February 1990	Merger	Banco di Roma given by IRI for a 35 percent stake in new holding company
Cassa di Risparmio di Torino (CRT)	Casse Vignola, Saluzzo, Savigliano, Tortona & Fossano	1991	Acquisition of stakes	CRT aims for effective distribution network in home territory
Cassa di Risparmio di Verona, Vincenza Belluno & Ancona	Casse in Bologna and Veneto	1991	Collaborative agreements	Reinforces territorial position with small and medium savings banks
Cassa di Risparmio di Parma	Cassa di Risparmio di Paicenza e Vigevano	March 1 1993	Merger	Created Cassa di Risparmio di Parma e Piacenza
Cassa di Risparmio di Bologna (Carisbo)	Bimer Banca	1994	Incorporation	Carisbo adopts universal bank structure
Cassa di Risparmio di Padova e Rovigo	Cassa di Risparmio di Venezia	1994	Joined banking group	Holding company is Casse Venete
Cassa di Risparmio di Biella	Cassa di Risparmio di Vercelli	November 23 1994	Merger	Created Cassa di Risparmio di Biella e Vercelli, known as Biverbanca
Fondazione Cariverona (Cassa di Risparmio di Verona Vicenza et al)	Fondazione Cassamarca (Cassa di Risparmio di della Marca Trivigiana)	December 13 1994	Reorganisation and co-operation	Created holding company Unicredito which owns Cariverona & Cassamarca
Cassa di Risparmio di Cuneo	Banca del Monte di Lombardia	December 23 1994	Merger	Created Banca Regional Europea

Source:Various annual reports

Table 4.3

Two 1991 agreements – between Cassa di Risparmio di Torino (CRT) and various *casse* (savings banks), and between Cassa di Risparmio di Verona Vincenza Belluno e Ancona and various *casse* in Bologna and Venice – were aimed at strengthening the two larger institutions' positions in their home territory through a series of strategic alliances with small and medium-size savings banks.

The liberalisation of branching regulations in relation to banks effected two strategic responses. First, banks attempted to strengthen their position in their home territories, usually through mergers or strategic alliances with smaller institutions; alternatively, a group of small savings banks joined together to create a larger single entity more capable of defending its position in the market. Second, after strategies aimed at consolidation in the home territory were fully implemented, banks could then opt to pursue a strategy of external growth or geographical expansion. The following extract from the Carisbo's (Cassa di Risparmio di Bologna) 1994 annual report illustrates this strategic objective:

> "Further progress was made in 1994 in the rationalisation and expansion of the retail network, in keeping with strategies laid down the previous year concerning the strengthening and consolidation of the presence of the Cassa in its traditional market and the Emilia-Romagna region, as well as the strengthening of operations in Rome and Milan...It must be noted that the Cassa is aiming at significant geographical development of its retail network, reflecting the need to increase its volume of operations and to strengthen its position as a universal bank following the merger with Bimer Banca SpA. Moreover, the Cassa intends to pay great attention to the new structure of the regional credit system following the intervention of credit companies from outside the region."

Other savings banks that followed a strategy similar to Carisbo's include the Cassa di Risparmio di Firenze, and the Cassa di Risparmio di Padova e Rovigo. The Cassa di Risparmio di Padova e Rovigo was established in 1822. From 1992 it has operated as a joint stock company (SpA), transforming itself from an old public sector entity into a newly-incorporated limited liability company. During 1994 it became part of the Casse Venete banking group, which also incorporates Cassa di Risparmio di Venezia, Factor Nord, Ge.ri.co. and Serint. The formation of the group was determined by a need for the component institutions to become stronger and more competitive.

Throughout the 1990s the large Italian private and public commercial banks have been expanding their activities into new geographical areas, thereby pressurising local savings banks and others. The small 'local' banks have adopted a mixture of strategies to keep larger competitors at bay. The merger between Cassa di Risparmio di Biella and Cassa di Risparmio di Vercelli to create Biverbanca is one such example. The rationale for the merger is given in Biverbanca's 1994 annual report:

> "The new bank takes on the fruitful traditions of two historic local credit institutions which, for over one hundred and forty years, greatly contributed to the economic development of the Biella and Vercelli provinces...Over the past few years, the need for small banks to enter into adequate aggregation agreements has become more and more pressing, given the objective to continue to effectively advance in the market...Our choice for a merger between neighbouring savings banks, with very few territorial overlaps and a diverse and easy-to-integrate clientèle base, went into this direction. A choice,

among other things, perfectly in line with the latest strategies of other important credit institutions in Piedmont."

Other key strategies are being implemented at savings banks across Italy, including:

- Cost-reducing measures in response to structural change;
- Combining with similar banks to offer a more competitive range of services;
- Inviting local investors (even large banks) to inject capital; and
- Increasing their number of local branches.

During 1997 the Italian banking system staged a recovery of sorts although the operating environment remains weak by European standards. A number of contributing factors to the improvements have been identified:

- The prospects of further sharp declines in short term interest rates through the convergence of European yield curve structures;
- A projected recovery in domestic GDP and credit growth rates from 1998 onwards;
- The peaking of non-performing loan levels in 1998;
- Prospective liquidity inflows from mutual funds; and
- The targeting of productive efficiency as a key management decision variable; and
- The prospects for increased consolidation within the Italian banking system together with the relaxation of certain restrictive practices which currently characterise the structure of the labour market.

With Italy being one of the founding members of EMU in 1999, there are particular ramifications for the Italian banking system. Both short-term and medium-to-long-term interest rates have fallen. Interest rate spreads decreased from 4.93 percent in January 1998 to 4.23 percent in February 1999 as a direct consequence of EMU and a more competitive environment.

The fall in interest rates has stimulated GDP growth and bank lending. The rate of growth in the latter, however, has outstripped that of the former. Bank loans grew by 8.8 percent between February 1998 and February 1999. The increased demand for bank loans can be attributed to more-favourable financial conditions facing both firms and households, which are a result of lower interest rates and greater macro-economic stability.

There has been a radical transformation in the way in which banks fund themselves. A shift of financial resources away from deposits with agreed maturity and repurchase agreements has been partially offset by an increase in overnight deposits, which grew by 14 percent between February 1998 and February 1999, and account for 42 percent of total bank funding. The calmer macro environment and lower interest rates have meant that the opportunity cost of holding overnight deposits has lessened. This has facilitated a recomposition of portfolios towards more liquid assets. Also, households have demanded more asset management products, which implies an increase in liquidity and thus in overnight deposits.

Furthermore, Italian banks are expected to benefit from cost reductions as they increasingly take advantage of outsourcing and through the securitisation of bad debts as a means of alleviating the problem of bad loans on the balance sheet.

Second, the increasing probability of further consolidation in the banking system is likely to be spurred by defensive actions relating to the needs for critical mass and the growth of market share. Although the Italian banking system remains one of the most fragmented in Europe, expectations are that the banking groups will form larger pan-national and supra-regional networks in an attempt to improve their pricing power. Consolidation is more likely to be effected through merger than through acquisitions activity. Throughout 1998 and 1999 there has been a series of merger proposals between already-large Italian banks to form even bigger (by Italian standards) banking groups. Thus far, some mergers have taken place, including the formation of San Paolo-IMI, Italy's new largest bank. In 1999 it was reported that Unicredito Italiano was hoping to merger with Comit, but Comit has entered into a share swap with Bank Intesa.

In 1997 the Ciampi Directive was introduced in Italy. The Dini Directive of 1994 had attempted to settle the question of bank ownership, which had begun with the passage of the Amato Law in 1990. The issue relates to the separation of the controlling foundations and their banks. The foundations are essentially non-profit entities, in contrast to the joint stock status of the banks that they control. Although the earlier directives had stipulated that the foundations were to dilute and relinquish control of the banks, there was still a need to settle the matter. Under the terms of the Ciampi Directive, the banks are given a predominantly private sector status while the foundations are allowed to perform their public vocation. Through a series of taxation incentives the foundations are encouraged to sell any remaining stakes they hold in the banks. In effect, the Ciampi Directive seeks to introduce a greater degree of transparency into the ownership of the Italian banking system. In 1997 over half of the assets of the banking system were owned, in one form or another, by foundations or by the Italian Treasury.

In 1999 the only major bank to be controlled by a foundation was Monte Paschi di Siena, although the foundations remained a dominant force in the second-tier and regional banks. A new law aims to restrict the foundations' activities to cultural and scientific interests. The foundations will not be allowed to buy shares in banks and they will have to reduce their existing shareholdings. A transitional period of four years is expected, with an incentive programme attached.

Scandinavia

Norway

After the crisis of the early 1990s the Norwegian banking system entered a period of consolidation during 1996 and 1997. The consolidation process has affected both the savings banks and the commercial banks sectors. A process of amalgamations of savings banks had created larger and more powerful entities, particularly at the district and regional levels. By December 1996 the ten largest savings banks accounted for nearly 70 percent of aggregate total assets, compared with 25 percent in 1970. Despite the concentration that has taken place among the larger savings banks, many small savings banks continued to base operations on strong, local ties and a reputation for financial soundness. This strategy of emphasising the 'home' area applies also to larger district and regional savings banks. The proximity to 'home' markets is an integral part of savings banks' strategy and is optimised through extensive branch coverage.

In 1996 the savings banks sector further consolidated through the creation of two powerful regional-based banking groups. The leading savings bank, the Union Bank of Norway (Sparebanken NOR), entered into an alliance with five[6] other savings banks to form the Sparebanken NOR Group, which has an extensive branch network (by Norwegian standards) of over 400 branches. The group will share EDP facilities and products while also co-operating in other areas such as marketing. The second alliance is built around the four[7] largest regional savings banks that have incorporated a joint stock company called Sparebankgruppen AS. These alliances came about in order to counter increased competition and improve cost-effectiveness. New types of product and new delivery channels are expected to impose a heavy burden, which can be spread more easily through the process of collaborative actions.

There remains a strong possibility of further consolidation. This is so at both the domestic and regional levels. During 1996 a hostile takeover bid by Sparebankengruppen of Fokus Bank came to nothing. This was partially because of the establishment of a co-operation agreement between Fokus Bank and the Sparebanken NOR Group, which holds a 10 percent stake in Fokus. Norwegian banks are not only smaller than their regional counterparts, they are also less profitable. In 1997 bank management in Norway began to emphasise the need for strong domestic banks to face the challenges of a deregulated and more-competitive European banking landscape. The issue of critical mass may be expected to increase the consolidation of the Norwegian banking system.

The outlook for the Norwegian banking system contains some positive factors. The banks' balance sheets have been cleansed of most non-performing assets and there has been an revival in capital strength. Bank efficiency ratios have also improved relative to the standards of the European core banking systems. The banking system has benefited from a strong economic performance and credit expansion has grown substantially. However, as GDP growth slows there will be less credit available. Increased competition in the savings sector means that the level of customer deposits can be expected to decline as other savings products gain in popularity. Consequently, a slow growth in net interest revenue is projected. The level of operating expenses has risen due largely to increased spending on IT, which reflects the increasing sophistication of banking products. Marketing expenses have also risen. These trends are likely to continue because of the present level of excess capacity in the Norwegian banking system and, as a consequence, future profitability levels are likely to be dampened.

Since the Savings Banks Act of 1977, savings banks have been authorised to carry out the same activities as commercial banks. The great majority of savings

6 The Sparebanken NOR Group consists of the following savings banks: Union Bank of Norway; Sparebanken Hedmark; Sparebanken Møre; Sparebanken Rana; Sparebanken Sogn og Fjordane; and Sparebanken Sør.

7 The Sparebankengruppen has been formed by the following savings bank: Sparebank 1 Nord-Norge; Sparebank 1 Midt-Norge; Sparebank 1 Vest; and Sparebank 1 SR-Bank plus a further 12 medium-size banks from the south east of Norway.

banks can transact or intermediate all important banking business. The core business activity is the collection of household deposits. Savings banks account for 44.9 percent of total deposits collected compared with 55.1 percent by commercial banks in 1998.

Savings banks have increased their market share of total loans to the public in recent years. Between 1996 and 1998 the savings banks increased their lending market share from 29.4 percent to 30.1 percent. Traditionally, savings banks have catered for the household sector (in which they are market leaders) while the commercial banks have dominated the corporate side. This situation has changed, particularly as the larger savings banks now compete with commercial banks in all segments of the corporate market. Smaller savings banks are becoming more involved, principally in local business and industry. The bulk of savings banks business remains with private individuals, though loans to private enterprises accounts for over one-third of total loans.

The competitive position of the savings banks has been substantially strengthened through collaborative projects. The savings banks group owns Fellesdata A/S, one of Norway's largest electronic data processing companies, and is one reason why the savings banks have been at the forefront of technological development. Norwegian banking services have become increasingly automated, more so than in other countries and particularly in the area of electronic cards services. The savings banks have been at the forefront of such developments since the introduction of the first ATMs in 1978. They have been the leading banking group in electronic cards services, issuing 55 percent of all such cards by the mid-1990s.

Sweden

Swedish bank management is continuing to prepare for the challenges of increased competition, deregulation, globalisation and technical innovation. In addition, there are threats and opportunities posed by EMU, particularly in terms of high implementation costs, loss of revenue streams and increased competition. Against this background, in February 1997, the central savings banks institution, Swedbank, merged with Föreningsbanken to create FöreningsSparbanken. The merger is further evidence of the regional and European trend towards increased consolidation that gathered pace in the run-up to EMU.

FöreningsSparbanken (Swedbank) concentrates its efforts almost exclusively in the retail banking market. It markets itself as a people's bank and has targeted the following main customer segments: private individuals, farmers, SMEs, local authorities and a limited number of corporate clients. FöreningsSparbanken has a customer base of approximately 5 million and an extensive network of 1,100 branches. From the year 2,000 the estimated synergy gains are about SKr1.5 billion per annum and there is potential for revenue increases as cross-selling opportunities are developed.

Prior to the merger, Swedbank extended its reach to customers through its co-operative association with the independent savings banks and their 350-strong branch network. The association accounted for 25 percent of the sale of bank cards, mortgages, and insurance products by the savings banks group. The co-operation between FöreningsSparbanken and the independent savings banks will continue. In 1998 more than 140 branches were sold to the independent savings banks. Of the combined branch network (of 1,100) 220 have been identified as overlapping, and a decision was taken in 1998 to close 215 of these branches. A reduction in headcount has also taken place through an early retirement programme.

Before the 1997 merger, Swedbank had operated as the clearing bank for all of Sweden's savings banks. The organisational structure of the bank was two-tier and decentralised: operations being run out of 130 individual Local Savings Bank Units (LSBUs), with a total of 624 offices. The LSBUs and the bank as a whole undertook reporting. The strategic objective of the structure was to undertake all business decisions at local level with the hope that 95 percent of decisions would be made locally. The central service units and Swedbank's subsidiaries support the LSBUs: they act as a financial marketplace and have the autonomy to decide which central services they will take and to whom they will offer such services.

In the retail market, Swedbank has been improving the distribution of its banking products, and particular emphasis has been placed on the pricing of products. This has been relatively successful given that market shares in the household sector have remained stable. A new telephone-banking subsidiary, Sparbanken Direkt, was established at the beginning of 1995.

The thinking underlying Swedbank's corporate sector strategy was more akin to traditional savings banking. The bank actively targets corporate clients operating within particular LSBU areas. Though Swedbank offers an extensive product range, the focus of its strategic drive are two package arrangements that allow corporate clients to receive a number of services for a subscription fee. A SKr200 million programme to facilitate loans to SMEs has recently boosted the strengthening of local ties. In targeting this customer segment, Swedbank is trying to increase its expertise and product range in the overall corporate sector. Despite delegating local corporate business to the LSBUs, a special central unit serves large corporate companies.

Swedbank operates an extensive private client portfolio. Savings and investment products are channelled through various subsidiaries – including retail bonds issued by Spintab, funds managed by Robur and life and pension products through SparLiv and SparFonds. Swedbank is the largest mutual fund operator in Sweden and a leading player in the growing pension and life insurance market. Housing finance is provided through mortgage bank subsidiary, Spintab, and control of this institution remains a key feature of Swedbank's operational strategy. Top-up finance and advice on property matters are arranged through another subsidiary, the real estate broker, Sparbanken Fastighetsbyra. Swedbank is dominant in the credit and debit card markets holding 42 percent of total market share through Sparbanken Finans.

At international level, Swedbank has concentrated on servicing Nordic clients' overseas business operations. This has been a fairly common strategy for Scandinavian banks and reflects the depth of the earlier banking crisis, which forced a reduction of banks' international aspirations. In reducing the scope of its international operations and focusing on core business areas, Swedbank has actively sought to reduce its foreign currency exposure. The scope of Swedbank's Nordic strategy has been relatively low key. The bank holds a 25 percent stake in the Finnish central savings bank, Aktia, which is a measure to broaden the cost base through a co-operative arrangement similar to that held with the independent Swedish savings banks. Another stake of 12.5 percent is held in the Estonian bank, Hoiubank. In addition, Swedbank has collaborative agreements with a number of regional banks including BG Bank in Denmark (through a 3 percent stake) and Sparebanken NOR in Norway.

Spain

The Spanish banking system is significantly different from other European banking systems. There are relatively few credit institutions (over 300 in 1997), which leads to a relatively high degree of concentration. The Spanish banking system has a high number of retail branch outlets, which makes Spain one of the most highly branched countries (measured as inhabitants per branch) in Europe. The relatively low level of urbanisation means that the size of branches is smaller than in other European banking systems. The small size of branches (the average number of employees per branch is 8.3 for commercial banks and 5.5 for the savings banks) makes deposits, and more recently, mutual funds collection relatively cost-efficient. Between 1987 and 1998 the average number of staff per branch has remained relatively stable in the savings banks sector while falling by around one employee per branch in commercial banks.

The savings banks are more widely distributed geographically than the commercial banks, which tend to be concentrated in the urban areas and tend to provide a broader range of products. The largest Spanish savings banks also have a strong presence in major urban areas and they offer a broad range of products and services. Although the commercial banks have more branches than the savings banks (17,530 compared with 16,653 as at September 1997) the pace of new branch openings between 1987 and 1996 has been over twice as large in the savings banks sector (17 percent compared with 7.5 percent). This has been due to both acquisitions and aggressive organic branch openings by the two largest savings banks, La Caixa and Caja de Madrid. The expansion in the branch network of the savings banks followed the liberalisation of restrictive opening regulations in 1988.

Competition between the commercial banks and the savings banks has increased in recent years, partly as a result of low short-term interest rates and the relatively depressed demand for credit. One outcome of this has been downward pressure on interest margins and bank profitability. In both lending and deposit markets the savings banks have gained market share at the expense of the commercial banks since the liberalisation of branching restrictions in 1988. Since then the savings banks have increased their market share of domestic lending to households and companies by an average of one percent per annum. By 1997 the savings banks market share in this customer segment was 40.1 percent; part of this growth can be attributed to the aggressive move into the SME customer segment. Although the savings banks have been relatively stronger in deposits business, since the end of 1995 they have noticeably increased their market share (to 49.3 percent by 1997 compared with the commercial banks' 45.2 percent).

One significant factor in explaining the growing divide in deposits market share between the two banking groups relates to the shift by customers have increasingly shifted into mutual funds. Since the commercial banks tend to have higher savings balances per customer than the savings banks, they are more affected by interest rate sensitivity. As a result, the impact of time deposit switching (due to reduced interest and deposit rates) into more tax-efficient mutual funds has been more pronounced for the commercial banks. By the end of 1996, however, the pace of deposit growth for the savings banks was slowing which signaled a similar dis-intermediation effect.

The switch of savings into mutual funds is expected to continue in the medium-term. Also in the medium-term demographic factors and increases in customer confidence will help boost mortgage lending; corporate lending is another anticipated growth segment. Interest margins can be expected to remain pressurised particularly in the light of the continuing trend towards dis-intermediation. The latter, however, can be expected to contribute towards the amount of non-interest income earnings as will the growth in pension funds and asset management business.

The banking model followed by the Spanish savings banks is that of universal banking. The deregulation process of the 1980s that encouraged savings banks to enter and compete in other market segments reinforced the universalisation trend in these institutions. This move towards universalisation by the Spanish savings banks is evidenced by the wider range of products offered (including mutual funds and insurance), in their recent internationalisation (sizeable increase in the business with non-residents and in foreign currencies) and in their rapid adoption of other financial innovations.

The move towards full-service banking in the Spanish savings institutions has been made in different ways:

- The largest Spanish savings banks have followed a merger and acquisition (M&A) strategy, together with the development of a wider range of financial products. Within the M&A strategy, the acquisition of medium-sized, regional-based private banks has been the most important activity with regard to enhancing universalisation. The acquisition activity has been developed as a way to enter the markets of a new region (through the existing branch networks of these private banks) and/or to increase the range of products offered. For example, La Caixa and Bancaja have followed this strategy.

- Medium-sized and small savings banks have more limited resources and have as a result developed their universalisation strategy internally. This strategy has more limitations than the M&A route: the process of universalisation, and diversifying activities and increasing non-interest income, through internal and organic growth is a slower route than that of acquiring a private bank. Banks pursuing an internal universalisation route need time and resources to adapt their organisational structure and employees' skills to the new full-service banking model. Mergers have been common between medium-sized and small Spanish savings banks. These mergers aim to achieve cost economies and other efficiency gains, and capital increases. The move towards further universalisation might also be one of the objectives. However, it was not the fundamental reason for mergers since the previously separate banks usually had a very similar range of products and competed in the same region and market segments. Therefore, the universalisation gains of this strategy seem to be more limited than those achieved by acquiring a private bank with a different mix of products.

In recent years the Spanish savings banks have been seeking to increase the loyalty of their traditional customers. They have introduced loyalty programmes such as:

- Free gifts for customers who have increased their average deposits or have made use of their debit or credit cards; and

- Special interest rates on loans and credit facilities if customers lodge their salaries into their savings bank accounts.

Such measures aim to discriminate in favour of the loyal customers. In recent years, as financial sophistication has increased among Spanish bank customers, a strategy that offers better prices for loyal customers has been more successful than the giving away of free gifts. However, it is likely to have a significant impact on savings banks' long-term profitability, as it tends to reduce the interest savings banks make from their traditional customers. Increasing non-interest income is a possible alternative, but this has its limitations. Non-interest fees are lower in the Spanish savings banks than in the private banks, and Spanish banks tend to compete aggressively on the commissions and fees they charge.

By 1996 some of the largest Spanish savings banks were developing strategies to try to capture a significant market share in the high-net-worth segment. The strategy aimed to capture and retain high-net-worth customers through increasing both the range and sophistication of banks' products and services. Because this strategy involved opening specialised branches and training staff for this specific market segment, it involved high costs at the beginning of its implementation. This is the main reason why only larger banks have undertaken the strategy. However, savings banks are aware that it seems to be necessary for them to enter this market niche in order to diversify their traditional customer base.

Another market segment of increasing importance for Spanish savings banks is the SMEs. After the deregulation process, Spanish savings banks have entered this market segment, which was traditionally dominated by private banks. It is a key market niche because of the quantitative importance of this type of company in Spain. The SME strategy followed by Spanish savings banks aims to diversify the banks' customer bases and business structures. Spanish savings banks realised that they were well prepared to compete in this market because of their strong links with the economic development and with the SMEs of their regions.

Despite Spanish savings banks' extensive branch networks in their respective regions, they have opened new, specialised branches (*sucursales de empresas*) for SME business in order to differentiate this new market segment and to provide a better service. This SME strategy has logically involved the creation of a separate department (which implies a change in the organisational structure of the bank) and the training of staff for the different financial needs of this market. Savings banks offer a wide, specific range of financial services and products (bills discount, short and long-term loans, leasing, usually through a subsidiary firm of the bank, factoring, as well as financial analysis of companies) that better suit SMEs.

The strong link between the Spanish savings banks and the economic development of the SMEs of their region is evidenced by the extensive involvement of the savings banks in the subsidised finance programmes for SMEs of both the central government and the autonomus regional governments. This high participation in these financial programmes appears to have helped savings banks to enhance their SME business.

The long-term success (measured by market share and return) of this SME strategy of the Spanish savings banks still remains to be seen. It is difficult to evaluate the success of this project at the early stages because of the high costs involved at the beginning of its implementation and the minimum period required capturing a significant market share. However, the good image of savings banks' regional and local economic links with, and the differentiated treatment for, SMEs may well produce the expected returns. The success of this strategy will also depend on the dynamic adaptation of savings banks to the emerging financial needs of the Spanish SMEs in increasingly competitive and globalised world markets.

Apart from the already-mentioned mergers between domestic savings banks (at a regional level) and the acquisition of some regional, medium-sized private banks, Spanish savings banks have not been very active in other types of strategic alliances such as international agreements. Most of the international alliances of Spanish savings banks involve participation in syndicated loans and agreements on the use of ATMs. So far, there has been no major international strategic alliance between a Spanish savings bank and a foreign bank. Their mutual legal status and the different cultural values seem to explain the relative lack of strategic activity at the international level. However, the large savings banks now seem more willing to undertake a strategy of international alliances in an increasingly competitive and ever more integrated European banking markets.

The UK

The building societies and the former TSB[8] (now merged with Lloyds Bank to form Lloyds TSB, a public listed company) constitute the core of the UK's traditional private savings banks sector. Although the building societies have largely maintained their traditional role as savings repositories and sources of finance for home ownership (and with a regional bias), there have been significant changes. These are reflective of the new competitive environment in financial services. In this environment the number of building societies has dropped from around 2,000 in the early-1900s to just over 80 today. The ten largest societies are strategically placing themselves as nationwide bancassurance operations, in order to compete with the main clearing bank sector. Most UK building societies have sought some diversification and increased distribution capabilities and all of them are re-appraising their traditional roles. Within this context, the issues of capital and mutuality are major strategic concerns.

The UK economic environment is characterised by low inflation and low interest rates. The current economic cycle is fundamentally different to earlier cycles, which were characterised by stop-go rhythms. The slow operating environment has supported relatively high levels of bank profitability over the past few years. While the outlook for income growth remains modest and growing pressure on margins is expected, the major UK banks now have control over their operating costs, which are expected to remain flat in the near future.

The way in which banks might be expected to enhance their income streams is through changes in the portfolio mix. While the current credit cycle shows no sign of turning there would appear to be a consensus among UK bank management that lending criteria should still be tightened. With no obvious signs that the credit cycle will change course there is every reason to expect UK bank profitability to maintain its present high level. A modest fall in profitability is likely to be the result of banks' equity bases becoming enlarged rather than earnings streams decreasing. The relatively high levels of profitability have enabled UK banks to increase their capital strength. The issue at present is whether the banks can find suitable investments for retained earnings. It would

8 The trustees savings banks originated in Scotland in 1810. Since then there have been many significant changes. The most recent change came in December 1995 with the merger of the TSB Group and Lloyds Bank to form Lloyds TSB Group, which is now one of the largest banks in the UK.

appear that they are unable to find such investment opportunities and so are returning capital to shareholders in the form of dividends or share buy backs. Thus, UK bank management is showing its present commitment to shareholder value.

The banks have been taking a growing share of the domestic house-lending market, the traditional preserve of the building societies. At the same time, the banks, government and insurance companies are increasingly taking savings business away from the building societies, although the latter still dominate the domestic savings market. In this highly-competitive and converging market, the building societies are recognising the need to be lean, fit and more focused.

One interesting feature of this new and more competitive environment has been the growth in co-operation arrangements between banks and building societies. Smaller building societies often sell banks' unsecured loans, branded with the name of the building society. The Bank of Scotland (in a 50:50 joint venture) helped the Halifax introduce its own credit card. The Bank of Scotland and the Co-operative Bank undertake a cheque clearing service for smaller societies. Some building societies (like the Skipton) also administer mortgages for banks. Banks and building societies both supply to the same customers.

Such co-operation agreements may appear to be inconsistent with the intensely competitive market environment of the UK in fact, they are the products of competition. A bank and a building society set up co-operation agreements in order to achieve a competitive advantage over other banks and building societies. Synergies (like economies of scale and scope) can be exploited, thereby benefiting both parties.

Competition and co-operation are also evident in the various link-ups between building societies and insurance companies. Traditionally, UK insurance companies made deals with building societies (and banks) in order to secure access to their extensive customer bases. The building societies acted as intermediaries in selling a high proportion of the insurance companies' life assurance policies and buildings and contents insurance. In exchange the building societies gained valuable fee income. Cross-selling and a drive towards bancassurance, have been important strategic differentiators of modern UK building societies.

Following the Financial Services Act of 1986 many building societies became tied to one insurance company – early examples include Alliance and Leicester and Scottish Amicable, and Nationwide and Guardian Royal Exchange. Several such tied relationships have developed into full ownership of an own-branded life company. National and Provincial (aided by General Accident) and Woolwich (helped by Sun Alliance) are examples.

Britannia has followed a strategy of acquiring existing life companies (for example, FS Assurance in 1989 and later Crusader Insurance and Life Association of Scotland). Abbey National also followed an acquisition strategy and purchased Scottish Mutual. These moves are evidence of the increasing acceptance by building societies of the advantages of a bancassurance strategy. They also signal the move away from co-operation between building societies and insurance towards greater competition. All of these trends are reflect the rapid erosion of distinct roles for banks, building societies and insurance companies. It seems likely that in the future individual financial services firms will offer banking, savings, mortgages, insurance and investment products. There is now a trend by the major building societies to set up their own life operations.

Some Building Societies have seized opportunities in Europe offered by the EU Second Banking Directive of 1989. The Bradford and Bingley, for example, has set up a Bausparkasse and marketing company in Germany and the Nationwide has also set up operations there. The Halifax has created Banco Halifax Hispania; the Woolwich has established Banque Woolwich in France and Woolwich in Italy. Abbey National was the first to enter Europe, offering mortgages in Spain and then Italy and it also started operations in France. Despite all these moves and the strengths of the UK building societies, they have generally found it difficult and not always attractive to exploit the apparent opportunities afforded by the single market.

From about 1993 there was renewed speculation on the future of regional building societies. With the following forces cited as pressures for regional building societies (all except the top 5 and bottom 30 or so) to merge or be taken over:

- Technology (ineffective and limited applications by many building societies);
- Mortgage losses (depressing profits);
- Management (lack of depth and skills);
- Capital (limits investment in new technology, infrastructure, new product development and expansion capabilities);
- Treasury (limited contribution);
- Customer preferences (larger size is perceived to increase safety and the bigger societies are better at marketing);
- Economies of scale (may be exploited by bigger societies);
- Costs (lack of effective cost management);
- Industry overcapacity.

John Wriglesworth, one of the leading UK building societies and housing market analysts, suggested at the time that the key criteria for the success of any building society would be:

- Developing sophisticated products targeted at particular customer segments;
- Lowering overall cost:income ratios;
- Improving risk assessment; and
- Focusing strategically on exploiting synergies and seeking to dominate well-defined market segments.

He also emphasised in this general context the need for building societies to position themselves effectively with regards to cost and distribution. Wriglesworth, argued that building societies were better positioned than banks to be successful in providing financial services for the following reasons:

- Building societies had more control over their net interest revenue because they had administered rates on both sides of their balance sheet;
- Building societies had a lower cost base since they had much smaller branch networks and simpler and fewer product ranges;
- Building societies had better technology in place;
- Building societies' bad debts were significantly lower than the banks; and
- Building societies generally maintained a better image with customers.

Wriglesworth also suggested that a major (anti-competitive) problem for the societies was the 1986 Building Societies Act. He argued: 'It is a complete anachronism within the context of a free market and contrary to the EC spirit of lowering anti-competitive barriers'. A major government review of the Building Societies Act began in 1994 and produced proposals in 1994 for a new bill.

A fundamental problem for the UK industry in the early 1990s was overcapacity: too many societies, too many branches and too many staff. In the face of intensifying competitive pressures building societies had several options:

- **Demutualising and becoming a bank.** This, at a stroke, achieves the funding and operating flexibility that building societies did not have under the 1986 Building Societies Act regime. The Abbey National became the first conversion in 1989 and in 1997 by the Alliance and Leicester, Halifax, Woolwich and Northern Rock building societies, all demutualised. The Northern Rock (once thought of as a bastion of mutuality) conversion of 1997 has prompted other UK societies to question their futures in a shrinking UK building societies sector. Northern Rock, however, states that it wishes to remain a specialist mortgage lender.
- **Purchase a bank.** So far only the Alliance and Leicester has done this through its purchase of Girobank (formerly an offshoot of the Post Office).
- **Merge.** The UK trend has clearly been towards an ever-smaller number of building societies. Alliance merged with Leicester in 1985 and took over Girobank in 1990. The Northern Rock merged with the North of England while The Halifax had already merged with the Leeds Building Society before The Halifax conversion in 1997. (The Lloyds TSB merger was also a highly significant move in the wider UK savings banks sector and has created the UK's largest retail bank. A study in 1995 by the institute of European Finance suggest that the greatest opportunities for cost savings in the UK banking market result from bank-building society mergers, rather than bank-bank mergers.
- **Sell out to a bank.** Cheltenham and Gloucester (C&G) took this route early in 1996. C&G pursued its strategy of being a low-cost mortgage lender within the larger Lloyds Bank group. This gives the C&G greater access to wholesale funding markets and the opportunities to exploit economies of scale. National and Provincial members have also voted overwhelmingly to join Abbey National. The Bristol and West was taken over by the Bank of Ireland in 1997, and the Halifax is seeking to acquire the Birmingham Midshires Building Society in the second-half of 1999.

Another interesting development in the domestic UK financial sector was the consolidation within the life insurance sector when General Accident (now CGU

Life) acquired Provident Mutual in January 1996. Similar consolidation moves were also apparent in the UK funds management sector about the same time. In the face of such consolidation and de-mutualisation in the building society sector, the question of the long-term survivability of mutuality is high on the agenda.

The Northern Rock conversion sparked renewed debate. While some societies such as the Yorkshire Building Society have said clearly that they believe mutuality offers the best medium to long-term benefits for members, others are not so sure. Many in the industry believe that the game is up for medium-sized societies. Two of the largest UK home loan groups (Nationwide and Yorkshire Building Society) appear to be strongly committed to mutuality.

In 1996 the UK government published draft legislation for the building society sector. The new regime was designed to ensure that building societies would grow, develop and compete effectively with other financial services institutions through the provision of a range of products and services to their client base. The legislation reflected the importance that the UK government attached to the sector as a safe repository for personal savings and a major provider of housing finance.

The first stage of this review (which began in January 1994) was announced in July 1994, proposed that in future societies would be allowed to:

- Raise up to 50 percent of their funds on the wholesale market;
- Make unsecured loans to incorporated businesses; and
- Own a general insurance company which could write housing-related policies – buildings, contents and mortgage payment protection insurance.

Following the second stage of this review, two further elements were introduced:

- Increased accountability of boards to members; and
- A plan for removing the bulk of the legislative restrictions on building societies' powers.

The overall objective was to make the building society sector more transparent and flexible, thereby encouraging competition and more consumer choice.

The new government plans of March 1996 made three other, very significant (and generally unexpected) proposals. The first and most important was to protect from outside bids (to 'ring-fence') for up to one year those societies planning to merge. Second, a rejected bidder should wait for a year after a failed takeover attempt before renewing its takeover efforts. The third proposal was to allow for some action on the part of society that experiences a large surge of new accounts from customers seeking conversion or takeover bonuses.

The long-term survivability of mutuality is a topical issue in this environment. Once a society has converted to a plc it cannot reverse the process, and there is a strong pressure to convert. Three main 'planks' have been suggested as the basis for a new stage of mutuality growth. The concept of the customer as stakeholder; long-termism (a characteristic of building societies and mutuality); and cost of capital (cheaper capital costs for building societies).

It is interesting to examine the key strategies of the converted building societies. The Halifax, for example, aims to become the leading provider of financial services in the UK. Its comparative advantage lies in its market leadership in the residential mortgage and retail deposits market segments (20 percent and 16 percent market share, respectively): this competitive strength provides the Halifax with a high degree of pricing power within the banking system. The Halifax aims to continue product development including current accounts, personal insurance, consumer credit and longer term savings products. Despite having a strong brand it is perceived that it will be difficult for the Halifax to gain sufficient market share in the current accounts market segment. To date, the Halifax has introduced a direct banking facility and longer-term savings products.

Like the Halifax the Woolwich is aiming to strengthen its position in its core market segment (the mortgage market) as a basis for broadening its product range and diversifying its earnings stream. The Woolwich is an interesting case because of its involvement in other European markets, notably in France and Italy where it provides mortgage-lending facilities. While the European operations contributed 3 percent to pre-tax profits in 1996 there were concerns about the level of bad debt charge made in 1996 which absorbed nearly 50 percent of operating profits. The Woolwich is striving to grow both its fund management and treasury operations. It is also considering expanding through acquisition: a suitable target would be a similar institution located in the north of England (the Woolwich is based in the south east of England).

The Northern Rock is a relatively small bank but unlike the other converted building societies its activities are almost solely focused on one business, mortgage lending and savings. Its comparative advantage lies in its efficient cost structure: in 1996 the cost:income ratio was the lowest of the converting building societies at 33.2 percent: The low cost structure is an important contributor to Northern Rock's profitability. Again unlike the other converting societies, the Northern Rock does not hold an excess of capital. A major contributor to its funding arrangements is the volume of postal savings received, which negates the need for an extensive and expensive branch network. This aspect of funding has provided the capacity for Northern Rock to rapidly increase the size of its mortgage book. In 1992 the volume of postal savings accounted for 25 percent of retail funding but had risen to 50 percent by 1996 and during the same period retail savings grew by 111 percent while the number of branches remained constant.

The conversion by Northern Rock has an interesting feature. The Northern Rock Foundation, a charitable body, was created at the time of the Northern Rock conversion in an effort to redefine the ethos of community spirit inherent in mutuality, but within a shareholder framework. The Foundation channels funds (mainly to charities) in the north east of England. The Foundation receives 5 percent of the banks' annual pre-tax profits it also has non-voting shares that can be converted into 15 percent of the bank's equity in the event of a takeover.

Conclusion

This chapter has highlighted many key trends in the strategies being pursued by European savings banks. Despite the heterogeneity of the sector, there are many common, trends and strategies being pursued. In all European sectors, intensifying competition and the demise of historical institutional boundaries are among the most important strategy drivers. Competition, co-operation, consolidation, privatisation and de-mutualisation typify many of the broad strategies being pursued by European savings banks.The pressures of an increasingly deregulated free market in financial services are fundamental strategic driver.

Although many savings banks sectors continue to emphasise their regional and local roles, there is a growing commonality between savings banking and bank strategies. The emphasis is on focusing on core businesses in the retail and SME customer segments while developing fee-based services such as insurance, pensions, private banking and fund management activities.