The challenge for savings banks in the changing financial environment

By Jean-Marie Pesant

THERE should be consensus that the financial environment is changing and that it causes a challenge for savings banks. This situation is hardly surprising as over the past two decades there have been changes in the international economy in the fields of trade, payments, indebtedness and exchange rates. As far as the financial sector is concerned, new legislation has been enacted with far-reaching reforms allowing institutions to respond to the challenges in the world economy. In addition, we must bear in mind the impact of technology on the changes we propose to discuss.

A tradition of alliances has already been established and I am sure that in time we will achieve the full potential of the savings banks sector with the benefit of an increasing market share nationally and internationally.

The changing financial environment

Deregulation and competition

In looking at the savings banks sector, we must recognise that while savings banks have originally been retail banks and this is a role that they wish to continue to play, it has been a question of survival that has obliged them to diversify their operations and become universal banks. This increased competition within domestic markets was the consequence of deregulation and, in the case of Europe, the prospect of a unified market.

If we look at the competitive aspect, it will be easily recognised that in addition to competition from the rest of the banking sector, competition from non-banking institutions in the financial market has taken on new dimensions in the deregulated environment. The origin and nature of this competition can be traced to the overall increase in the volume of transactions on the financial market and the growing despecialisation of several non-banking intermediaries. This competition is characterised by the fact that it puts the banking sector at a disadvantage since non-banking institutions benefit from privileges whereby they carry out banking operations without meeting the legislative restrictions to which banks are subjected.

It is therefore a consequence of these developments that the business structure of the savings banks and their business policies follow more the requirements of their customers rather than any traditional demarcation of activities.

Equity capital and costs

The expansion of business, and the often substantial investments that have to be made in equipment and technological adaptation, have placed a new burden on savings banks for capital. Some savings banks have been able to respond well to these new demands as they have changed their statutes and become joint stock banks, as is the case in the United Kingdom. Others will be able to choose this option in the near future, for instance in Denmark. Yet elsewhere, savings banks have raised capital by issuing participation certificates. These institutions can turn directly to the public and raise capital to meet the needs of their growth and their enhanced competitiveness. In the context of a single European market, banks will find themselves subject to the EC's own funds directive and its solvency ratios directive which will harmonise capital adequacy rules throughout the banking sector.

These directives which are still in draft stage are expected to conform to the Cooke Committee requirements of 8% of total capital to risk adjusted assets. The implications of the completion of a single market will be significant increase in competition in the domestic market together with greater opportunities for corresponding expansion of activities throughout the European Community. All banks face this challenge and I believe we can identify three specific components:

Financial margins will be under increased pressure as more players compete for deposits and loans.

Control of operating costs will be crucial and will determine which banks come out as efficient and profitable.

A comprehensive package of financial products and services will be required from banks.

The strategies

In view of the situation in Europe, but also taking into account the banking sector throughout the world, it has been necessary to look at the options available. From an analysis of the strategies of different types of banks, it is hardly surprising that the approaches they find appropriate are quite similar, as they operate in a global environment and the rules are the same for all the players. These are:

- To create bigger pools of capital and achieve economies of scale through mergers.
- To gain a foothold across the market through acquisitions abroad which include non-bank financial institutions and expansion of networks by setting up branches in other countries.
- Establishment of alliances to build a network of partners chosen on the basis of a common corporate culture and converging management goals.

Let us now look at each of these separately with examples as to how various institutions in the savings banks sector have adopted these strategies.

Mergers

Size will have a crucial influence on savings banks as it will determine the level of overall resources that will be available. It will only be the largest institutions, the best structured organisations and those that can establish solid ratings and become fully-fledged members of the international banking community that will succeed. It will be important not to be too small to meet competition and savings banks in many countries are engaged in the process of mergers in order to attain the required strength and volume. Here are a few examples.

Germany. In 1987 alone, the number of savings banks was reduced by three including a well publicised merger between two savings banks in the Frankfurt area, one of which was a large private savings bank. The new bank, which became operational on 1 January, 1989, is number four in terms of balance sheet in the ranking of German savings banks. This year the focus has shifted to the central institutions known as the Landesbanken. The first such merger was between the Badische Kommunale Landesbank (BAKOLA) and the Landesbank Stuttgart GZ. The resulting institution is called the Baden-Württemburgische Landesbank and serves 92 savings banks.

There is also the suggested grouping of the Landesbanken of the four northern states of Schleswig-Holstein, Lower Saxony, Hamburg and Bremen. A merger between the Bayerische Landesbank GZ and the Landesbank Rheinland-Pfalz has also been talked about. The principal case with profound ramifications is a planned merger between the Westdeutsche Landesbank GZ (WestLB) and the Hessische Landesbank GZ (HELABA). WestLB is the largest Landesbank and overall the third ranking bank in the country. The merger with HELABA would bring with it a strong footing in Germany's dominant financial centre of Frankfurt as well as access to the fast growing economy in the southern part of the country.

According to an analysis carried out by a prestigious consulting group, the synergy of the merger would increase earnings by some DM200 million and possibly DM500 million. The merged bank would rank only second to Deutsche Bank and have assets of about DM230 billion and would strengthen the competitive position of the savings banks sector against the aggressive private banks in the private banking market of high net-worth individuals and that of medium-sized businesses.

Italy. In Italy, for instance, mergers between the savings banks of Prato and Florence and later with Bologna are on the cards. If this should come off, it will form the second largest savings bank in the country after CARIPLO. According to an Italian savings banker, the country is gripped with merger mania. For instance, a merger is planned among 11 small savings banks from the Piedmont and Liguria areas to be called ACROPOLI. It will have 250 branches.

The Emilia region is also in the process of having a merger between the local savings banks with grouping having a network of 200 branches.

Spain. The process of mergers is also taking place in Spain. In the Basque country a merger is pending between the Caja Vizcaina and Caja Municipal de Bilbao. Regional mergers are likely to continue and according to views of the Spanish Savings Banks Association, the ultimate result could be 16 or 17 regional savings banks.

United Kingdom. The list of examples is long and interesting, but I will just mention the TSBs in the UK which are the most striking example of successful mergers. The number of savings banks was reduced by amalgamations from a 19th-century peak of over 600 to 73 banks in the early 70s. In 1976, they merged into 19 regional institutions. In 1983 further substantial mergers took place, reducing the number to four. Now, the group has transformed itself from savings banks status into a leader in the United Kingdom's financial services sector.

Acquisitions and network building

Acquisitions of other financial institutions and expansion of the network of branches represent the second possible strategy. The objective of acquisitions can be summarised quite simply in the words of Mr Hubert Detremmerie, chairman of the BACOB Savings Bank of Belgium: "We envisage the establishment of a conglomerate of specialised financial institutions that can furnish a full range of high quality financial products and services throughout the European Community and beyond".

This objective defined by BACOB has been translated practically with

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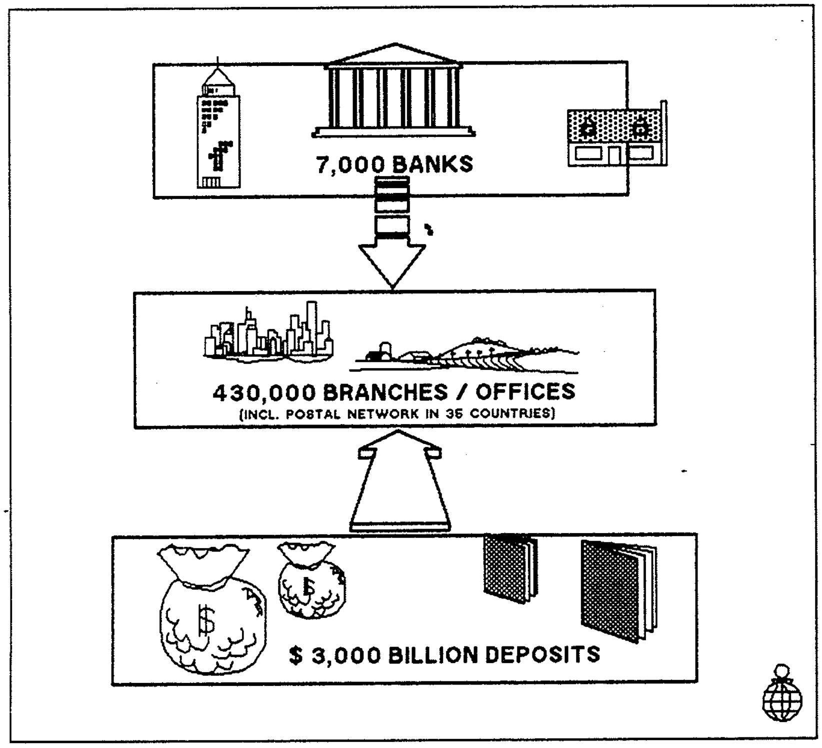
the acquisition of Banque UCL in Luxembourg together with other Belgian savings banks. In the field of securities trading BACOB has a participation in the London-based IFMT (International Financial Markets Trading) as well as a Dutch subsidiary BACOB Finance NV.

BACOB Delaware Inc has also been established to issue commercial paper in the New York market. Finally, it has acquired 25% of the capital of Continental Bank (Belgium), a subsidiary of Continental Illinois, and will use it as a dealing and merchant bank.

Other examples that bear witness to this strategy of acquisitions abound. One interesting situation is the merchant banking venture whereby Italy's ICCRI got together with the Banque Bruxelles Lambert to form ICCRI-BBL. The objective of ICCRI-BBL is to trade Italian and foreign securities, money market instruments and provide M & A advice. Further, the largest Italian savings bank CARIPLO is giving up a 30% stake in Istituto Bancario Italiano for an equivalent participation in Banco Jover of Barcelona which belongs to Banco Santander of Spain. CARIPLO has also bought Compagnie Internationale de Banque in Paris from the Société Financière Globe in order to have a more complete presence than a branch alone can provide in Europe.

In the UK, the TSB Group acquired a finance house, UDT, in 1987 and last year the merchant bank, Hill Samuel. Through Hill Samuel, the TSB Group can build upon a network of offices and associates in Europe as well as in New York, Hong Kong, Sydney and Tokyo. It has diversified through acquisitions into such areas as insurance, corporate banking, consumer finance, transport and offshore business. The Group is a volume banker in certain parts of the market and a niche player in others aims to be a major force in the financial sector in the UK. An institution of this nature is the response to the changing conditions and can be termed as a global approach and is called a group for its functions go way beyond that of a traditional bank.

SAVINGS BANKS - A FORCE



In view of this increased international presence of savings banks, the International Savings Bank Institute (ISBI) has published a Savings Banks Foreign Business Directory as a useful tool for all banks actively engaged in international business, enabling easy identification of more than 500 foreign contacts. In the 1988 edition of our savings banks foreign business directory, the banks listed are those which have links to SWIFT or which have foreign representative officers, branches or subsidiaries. The information in the directory covers 364 addresses of 176 savings banks or affiliated banking institutions in 38 countries.

Alliance strategies

Savings banks' organisations from different countries have responded to market forces according to the volume of their business and their size in order to have an international presence. The big German Landesbanken have been present in the major financial centres since the early 70s and have principally done so independently. Other institutions that have entered international markets more recently have started out with representative offices and later with branches and subsidiaries. These have been done essentially in co-operation with other similar institutions from the home country such as the joint representative offices of Italian savings banks in London, or through joint representation with other friendly savings banks.

Examples of this would be the former representative offices in Singapore of SDS Copenhagen and the Caisse d'Epargne d'Etat de Luxembourg, or in the case of private banking a partnership of savings banks in TSB International Luxembourg. Another interesting example is the agreement among savings banks central banks in the Nordic countries to represent each other in their respective markets.

However, with the approaching unification of the European market, agreements across frontiers such as between the Savings Bank of Barcelona, the Savings Bank of Paris and CENCEP of France could become common. Maintaining offices abroad is a costly business and a more economic way is for several banking institutions to pool their resources. Within the savings banks sector, co-operation agreements are common because of close ties between the institutions in different countries.

Another area where savings banks have used alliances is in the field of underwriting. Whenever a savings bank has been influencial in an underwriting syndicate, other savings banks have regularly been invited to participate. Until recently, there were two savings banks consortia to underwrite loans for the World Bank, one led by the Bayerische Landesbank and the other by the Deutsche Girozentrale.

These two have recently been merged but the idea of a savings banks consortium continues to play its role. The strength of the savings banks sector has been recognised in the field of capital markets and it intends to be a strong competitor in the future. This strategy of alliances serves to increase profitability by modifying investment structures from the long term to the shorter term, to seek new customers and product strategies in order to secure better yield. It is essential to act with speed in order to identify those market niches, modest but still profitable, which savings banks, by acting quickly and in co-operation, can exploit first.

A global approach

The Institute has members in some 75 countries all over the world, but the major financial force of savings banks remains in Europe. The ISBI is the world-wide representative of this community of savings banks and operates as a centre for information and communication. It endeavours to promote the exchange of experience and to facilitate practical co-operation among its membership on a global basis.

In talking about globalisation, we should remember that there is a vast world market. I wish to make the point that the Asian Pacific Rim countries are the fastest growing and the largest developing region in the world. Also, in many of the Advanced Developing Countries (ADCs) the gross domestic savings rate exceeds 25% of GNP: Korea (35%), Taiwan (40%), Singapore (25%), Thailand (25%), Hong Kong (27%), Indonesia (24%), Malaysia (32%) and China (36%).

While Asian ADCs benefit from exports to the United States, it is Japan which has the largest share in their imports, and while the United States has managed to increase its share of exports to Asia even as its share of world exports has declined, the major area to lose out in sales to the Asian market over the past 25 years has been the countries of the Common Market. Another important area not to be neglected for the future is Eastern Europe. Here, too, the process of deregulation of the financial sector has resulted in reforms in many countries such as Bulgaria, Hungary, Poland, Romania and the USSR. The market has enormous potential and savings banks central banks such as Skopbank and Swedbank from Finland and Sweden have already established representative offices in Moscow.

In addition to these, representative offices are also maintained there by the WestLB, the ZBank of Vienna and the Ljubljanska Bank from Yugoslavia. There can be no doubt that diverse forms of partnership can benefit savings banks: exchanges, twinning, agreements, conventions, investment funds, subsidiaries, representative offices, consortia or joint ventures, to mention but a few. Each savings bank can continue to extend the list.

Whereas up to now co-operation had tended to develop mainly within each zone — West and East — the potential for intra-European co-operation between savings banks is vast. Exchanges have taken place regularly between savings banks in Western Europe and their counterparts in the East for more than 20 years. It is clear that, as the overall liberalisation of the political and economic context progresses, so will the scope for co-operation expand more easily and quickly.

On the other hand, in response to our day-to-day needs, regular annual meetings of foreign exchange dealers and foreign department managers have proved to be highly popular and we believe they served their purpose of increasing contacts among practitioners which result in tangible forms of business co-operation. Judging by the continued success of these events, it can be said that they promote international co-operation in concrete terms and that the nature of subjects and discussions have widened in scope and quality.

This is, indeed, a reflection of the individual and collective importance of the savings banks sector which is an important force in the financial community in different countries. We have a tremendous challenge ahead of us, and one which heralds a very promising future. ■

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