Cross-border alliances in banking and financial services in the single market

Over the last decade, the banking and financial services industries in the European Community, and elsewhere, have experienced dramatic change. Market deregulation, increasing competition and new technology have made firms reassess their strategic objectives. Another significant source of change within the EC has been the creation of the single market in financial services.[1] *This paper looks at the cross-border alliances undertaken by banking and financial services groups in the EC since 1987 and the extent to which these have been prompted by the single market.*

Section I briefly outlines the pressures faced by financial institutions during the last decade. It also highlights some of the strategic options which are, in principle, available to firms that wish to take advantage of the opportunities created by the single market. Section II looks at strategic moves already undertaken by financial companies. Two hundred and forty-seven identified cross-border alliances by financial institutions have been analysed, and trends in the behaviour of firms by nationality and type are discussed.

Finally, Section III assesses to what extent the single market has encouraged financial services companies to undertake cross-border alliances and discusses some of the factors which are likely to affect such activity in the future.

I Pressures for change

The pressures for change to business strategies in financial services have come from a variety of sources in the last decade. Changes in market structure have been particularly prominent. Deregulation and the abolition of protectionist market structures were worldwide trends in the 1980s, with major structural changes implemented not only in Europe but also in the US and Japanese financial markets. Perhaps the most important were moves to abolish exchange control regulations. Other structural changes included the removal of legal barriers and administrative regulations which have allowed acquisitions, mergers and other alliances to take place, both within domestic markets and across national frontiers.

At the same time, technological advances have had a significant impact on the way in which financial services are provided. By lowering the costs of entry, new technologies have enabled institutions to enter or compete in new markets. Examples include telephone or screen-based banking and the sharing of ATM networks.

More recently economic pressures have led to large losses in domestic markets for banks, and weak demand for financial services more generally. The introduction of international supervisory agreements has forced banks to focus more closely on returns on capital. As a result, firms have scaled down or sold off activities which were not deemed to be 'core'. For others, the sale of these businesses has presented opportunities to develop their European strategies.

Against this backdrop, firms have also had to consider their response to the single market programme detailed in the European Commission's 1985 White Paper. One of the more detailed studies into the impact of the single market, the 'Cecchini Report',[2] argued that regulation in domestic retail markets was largely responsible for preventing price competition, the economic cost of which was passed on to consumers. By removing restrictive regulations, the single market was expected to create opportunities for financial services companies to compete in foreign markets that were previously closed to them, so leading to improved efficiency and lower costs to consumers.

Options for cross-border alliances

Various studies[3] into possible bank strategies were conducted when the single market programme was first published. They tended to suggest that cross-border mergers of major banks would be unlikely since larger banks would not wish to lose their identity in a merger and had least to gain from doing so. Mergers between institutions in domestic markets and between smaller banks were judged more likely as firms attempted to strengthen their position relative to larger organisations or pool complementary

(1) For a detailed analysis of the single market in financial services see 'The EC single market in financial services', *Bank of England Quarterly Bulletin*, February 1993.
(2) Summarised in 'The European Challenge 1992. The Benefits of a Single Market', Paulo Cecchini, 1988.
(3) For example, a survey conducted by the Bank: 'The single European market: a survey of the UK financial services industry', *Bank of England Quarterly Bulletin*, August 1989.

Domestic alliances

Alliances between financial companies within domestic markets are beyond the scope of this paper. But it is important to recognise that restructuring in domestic markets and the consequent degree of concentration can affect the degree of cross-border activity. Institutions which have been busy with domestic alliances may not be in a position to devote resources to a major acquisition programme abroad. More generally, markets which are highly concentrated offer relatively few new opportunities either to new entrants or to existing companies. Other things being equal, companies in such markets would more probably focus on acquisitions abroad.

This analysis would appear to be borne out by experience so far. Perhaps the most concentrated of the national markets is that of the Netherlands where the largest three banks have been estimated to account for 80% of the domestic markets in total and 90% of retail loan markets. The number of alliances made by Dutch firms abroad was significantly higher than the number of alliances made by foreign firms in the domestic market. Markets which appear to be less concentrated were those of Italy and Spain (in the latter the top six banks accounted for approximately 38% of total deposits as at end 1989). In Italy this appeared to make little difference to the numbers of inward and outward alliances which were broadly equal, whereas in Spain inward alliances were higher. This may be because the Italian markets were more highly regulated.

It could be argued that in the short term, by forcing national authorities to deregulate, the single market has led to greater concentration and less competition in domestic markets as domestic firms have merged in order to improve their competitive position relative to potential foreign competitors. Countries such as Spain, Italy and Holland have seen a number of mergers of major domestic banks: in Germany, the small co-operative and savings banks have been engaged in restructuring, through merger and alliance, in response to domestic competition.

resources with the aim of doing business more effectively across Europe.

For similar reasons, acquisitions of smaller companies or businesses by larger ones were also considered likely; so were loose alliances, share swaps and co-operation agreements among smaller institutions. Other options included the establishment of new operations in the form of branches or subsidiaries or the direct selling of services into foreign markets; the opportunities for the latter in an area such as Europe (with its different languages and diverse customs and traditions) were, however, considered rather limited.

The single market was not expected to have much impact on financial institutions' strategies for wholesale business. Historically, foreign banks have penetrated wholesale markets (corporate banking, money and capital markets and corporate advisory work) much more than retail markets, reflecting the fact that wholesale markets are, in general, more contestable. Sunk costs will generally be lower since there is no need for large, costly distribution networks and, given the global nature of markets such as foreign exchange and treasury, reputations established in one geographic centre can be more easily transferred to another. These factors tend to make it easier to sell wholesale services cross-border. It is not surprising therefore that the largest banks from each Member State have for some time been represented in wholesale banking markets in London and Luxembourg and a number (mainly German and French) are well-established in the UK equities and euromarkets. Foreign banks have also become increasingly involved in the wholesale markets of other centres.

By contrast, retail financial services markets (consumer credit, mortgages, life assurance, personal banking etc) have been far more fragmented in terms of their national (and in some cases regional) characteristics. Also, retail business has generally been highly profitable, especially for many of the larger banks in the Community, and should therefore be attractive (at least in principle) to financial institutions in the development of their strategies within the single market.

In practice, institutions have expressed considerable scepticism[1] as to whether retail markets are in fact contestable and on the real opportunities that the single market would create in this area. A particular problem is that of acquiring the necessary distribution network to attract retail customers, often because the major national banking markets, and to a lesser extent national insurance markets, comprise a small number of large and dominant institutions. It is clearly in the interest of incumbent firms to employ the substantial sunk costs (very large distribution networks, reputation, skills and knowledge of the market/customer base) to prevent new competitors from entering their markets. Cultural differences and other factors such as legal and regulatory practices have also been cited as impediments to potential new competitors.

II A review of cross-border alliances, 1987–93

For the purpose of this article a sample of 247 cross-border alliances between EC financial institutions has been studied. The data have been gathered from a number of sources, predominantly the national press but also analysts' reports and other specialist financial publications. The data therefore cover major cross-border alliances which have received more than minimal press coverage. It is not a comprehensive list of all cross-border alliances undertaken

(1) Ibid footnote 3, page 372.

Cross-border alliances — country of origin of 'target' and initiating companies

Initiating company's country	Target company's country									
	France	Germany	United Kingdom	Spain	Italy	Netherlands	Portugal	Belgium	Others	Total
France	XXX	6	18	19	10	2	7	5	7	**74**
Germany	10	XXX	5	9	5	2	1	2	1	**35**
United Kingdom	7	4	XXX	6	9	2	2	2	4	**36**
Spain	7	6	4	XXX	3	2	7	4	—	**33**
Italy	10	4	3	8	XXX	—	1	—	1	**27**
Netherlands	5	2	5	4	1	XXX	1	4	2	**24**
Portugal	1	—	—	3	—	—	XXX	—	—	**4**
Belgium	2	—	—	—	—	2	—	XXX	4	**8**
Others	2	—	4	—	—	—	—	—	XXX	**6**
Total	**44**	**22**	**39**	**49**	**28**	**10**	**19**	**17**	**19**	**247**

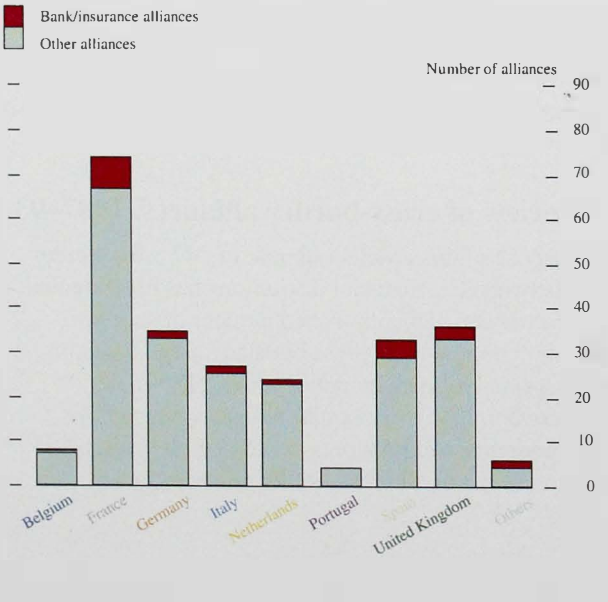
within the EC, and does not cover instances where financial companies have opened branches or sold services directly across borders.

EC cross-border alliances analysed by country

Chart 1 and the table summarise the data used for this study. Chart 1 shows total alliances according to the nationality of the company initiating the alliance, and the table shows a matrix of the number of alliances established by firms in each country, with firms from all the other countries. For example, reading horizontally, German firms entered into alliances with 10 companies from France, 5 from the United Kingdom, and 9 from Spain, with 35 in total. Reading vertically, a total of 44 French companies were the subject of alliances sought by firms from Germany (10), the United Kingdom (7), Spain (7) etc.

According to this data, French institutions have been by far the most active in seeking alliances abroad, accounting for 74 of the overall total of 247. Half of their 'targets' were in the United Kingdom (18) and Spain (19): only 6 alliances were pursued with German institutions. Firms from the United Kingdom and Germany appear to have been much less active, initiating respectively only 36 and 35 alliances.

Chart 1
Cross-border alliances within the EC, 1987–93



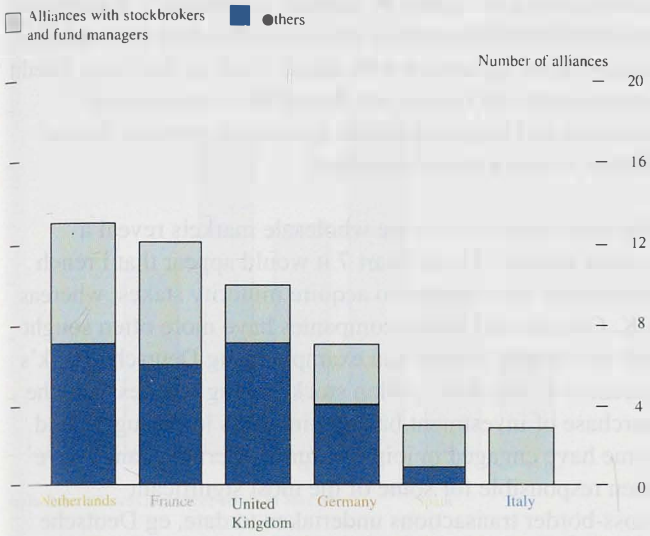
Overall, Spain (where 49 alliances were formed) and France (with 44) appear to have been the most popular 'target' countries, followed by the United Kingdom (39), Italy (28) and Germany (22). Earlier research suggested that France, Italy and Spain were potential markets for mortgages, retail loans, private banking and personal financial services (life assurance and mutual funds). France and Italy were expected to attract interest because of their size and wealth, and Spain was considered at the time to offer the greatest growth potential.

At first glance it may seem surprising that Germany has not been a major target given the strength of the economy and the wealth of its individuals. However, the German markets have a number of structural features (established protective

Non-EC institutions

Our data do not cover alliances by institutions located in non-EC countries. There is little evidence so far to suggest that such firms have used subsidiaries incorporated in the EC to branch across Europe, although this has only become possible this year with the introduction of the EC 'passport'. Such firms have tended to concentrate on markets such as foreign exchange, trading in primary and secondary securities markets, global custody and fund management services which, by their global nature, are easier to sell cross-border. In addition, they tend to provide services for customers from the 'home' country. This captive business can be undertaken from a single major European centre. Finally, as one might expect, developments in the main home market have far more significance for such firms and would appear to be the main influence behind domestic and international strategies. The withdrawal from, and scaling down of, certain activities by US and Japanese institutions in recent years was in part a response to more difficult domestic conditions. There is, however, evidence of some firms retaining a separately incorporated presence in the EC, as a potential base from which to branch in the future, even though such a presence is not currently justified on purely economic grounds.

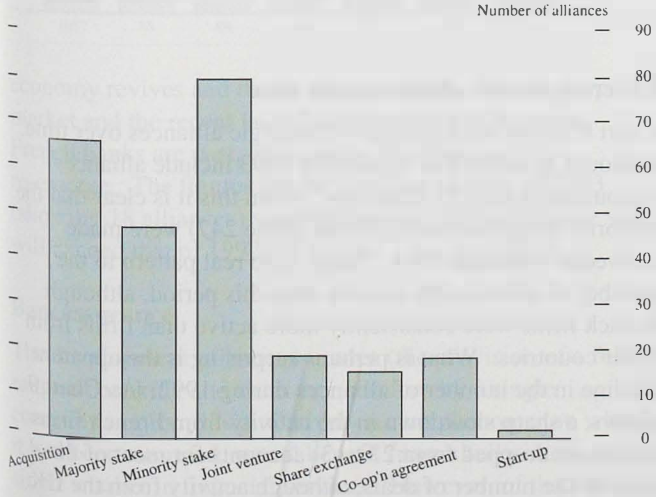
Chart 2
EC cross-border alliances in wholesale markets, 1987–93



ownership structure, historic strong bank/customer relations, customer loyalty) which would suggest that the German financial sector is not easily contested.

Forty-eight of the cross-border alliances studied appeared to relate specifically to wholesale markets.[1] But, for the most part, it would seem that firms have been able to meet their requirements in wholesale markets by using their existing presence in these markets. Chart 2 shows that firms from the Netherlands, France and the United Kingdom were the most active in initiating market alliances—and in each case alliances with stockbrokers and fund-managers accounted for the majority of the transactions. On the basis of the data Italian and Spanish firms showed relatively little interest in wholesale alliances. The most targeted wholesale markets (not shown in Chart 2) were those of the United Kingdom (15) and France (11). Markets in Germany, Spain and Italy together, were targets for another 18 firms. The interest in the United Kingdom and to some extent France may reflect

Chart 3
Cross-border alliances within the EC, 1987–93 (by alliance type)



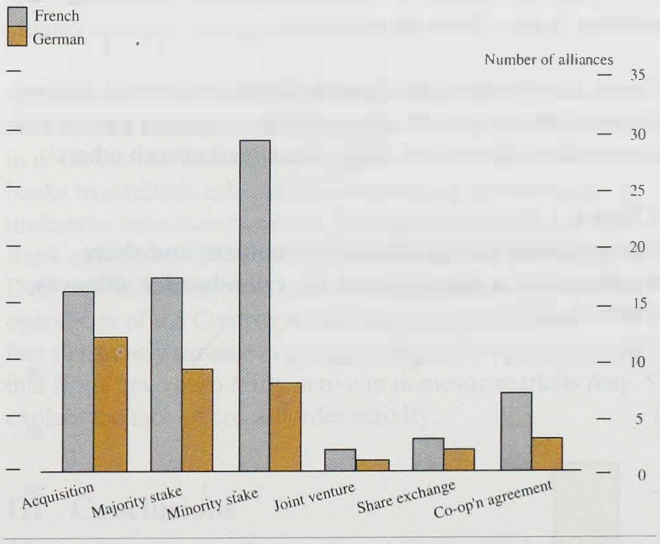
the size of the markets and the experience and skills available there.

EC cross-border alliances by type

Chart 3 summarises the different types of cross-border alliance in the sample. The most common form of cross-border alliance has been the purchase of stakes in small entities by larger institutions which have a dominant position in their domestic market. Outright acquisitions, or the purchase of a majority stake, totalled 113, or 46% of the sample. Purchases of a minority interest were also popular, accounting for 32% of the deals. It is possible that a number of these alliances (and perhaps also some of the share exchanges shown in Chart 3) may lead to full-scale acquisitions or mergers in due course. By contrast, joint ventures—which are often cited as an attractive route for firms wishing to enter unfamiliar markets—accounted for only 19 (8%) of the total sample.

In contrast to domestic alliances, there have been no cross-border mergers between institutions with a dominant position in their domestic markets. A number of such deals have been proposed—significant examples include the merger of AMRO/Generale de Banque and ING/Bank Bruxelles Lambert—but have failed to be completed. Differences in culture and management style were factors in both cases although disagreement over the cost was also cited in the latter case (giving some justification to the concerns about the expense of acquiring EC-wide networks expressed by UK firms in the Bank's 1989 survey[2]).

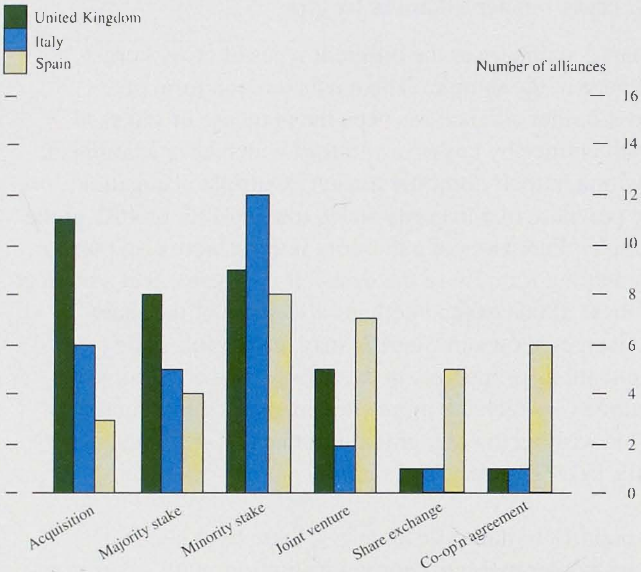
Chart 4
French and German cross-border alliances within the EC, 1987–93 (by alliance type)



The preferred method of expansion appears to have varied between countries. Charts 4 and 5 show that German and UK institutions seem to favour buying entire business units and majority stakes. These two methods accounted for 60% of German and 53% of UK alliances (with six of the seven alliances forged by Deutsche Bank involving stakes of over

(1) In other transactions in the survey, the wholesale markets activity of firms may still have been a significant, but not necessarily a decisive, factor in bringing firms together.
(2) Ibid footnote 3, page 372.

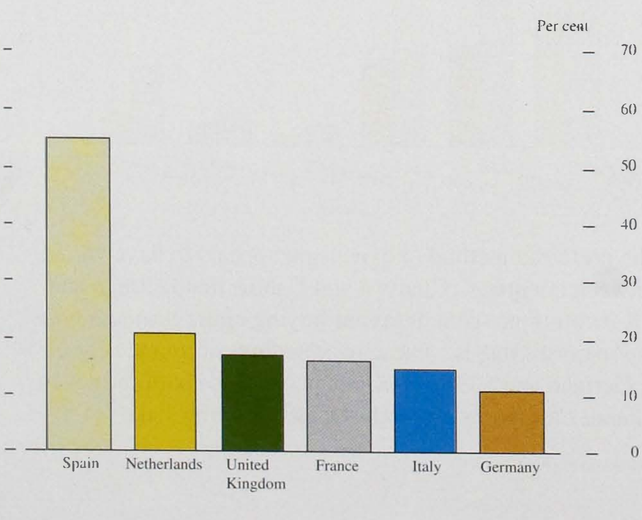
Chart 5
UK, Italian and Spanish cross-border alliances within the EC, (by alliance type)



95% and the other in excess of 50%). This may be a result of a combination of factors: the strong position of these relatively large institutions in their domestic market, the strong performance of the domestic economy (at the time) and, in some cases, the historically strong capital positions of the institutions. By contrast, as Charts 4 and 5 show, a much greater proportion of alliances made by institutions from France and Italy have been in the form of minority stakes (39% and 44% respectively). This is not, however, true of all institutions, notably Credit Lyonnais, for which 7 out of 11 alliances involved outright acquisitions or majority stakes. In the case of Italy this may be because the main banks are smaller than in Germany and have a less dominant position in their domestic markets.

Charts 5 and 6 show that Spanish institutions appear to have favoured the creation of joint-venture companies and formal co-operation agreements (eg to cross-market each others'

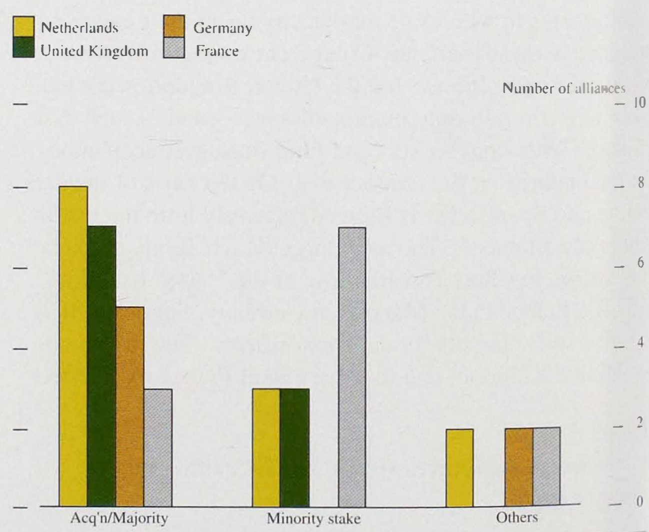
Chart 6
Co-operation agreements, joint ventures and share exchanges as a share of total EC cross-border alliances, 1987–93



products through their retail networks), often including some form of share exchange (they accounted for 55% of the total transactions undertaken by Spanish companies). Examples include Banco Santander's cross-shareholding and business co-operation agreement with Royal Bank of Scotland, Credit Commerciale de France and Banco de Commercio de Industria and the co-operation agreement between Banco Bilbao Vizcaya and Lloyds bank.

The data on activity in the wholesale markets reveal a similar pattern. From Chart 7 it would appear that French institutions have tended to acquire minority stakes, whereas UK, German and Dutch companies have more often sought full or majority control (an example being Deutsche Bank's purchase of Barclays' Milan stockbroking business and the purchase of investment banking interests in Portugal), and some have engaged in joint ventures. German banks have been responsible for some of the most significant cross-border transactions undertaken to date, eg Deutsche Bank's purchase of Morgan Grenfell, Hypo Bank's investment in Foreign and Colonial and WestDeutsche Landesbank's initial joint venture in merchant banking with Standard Chartered.

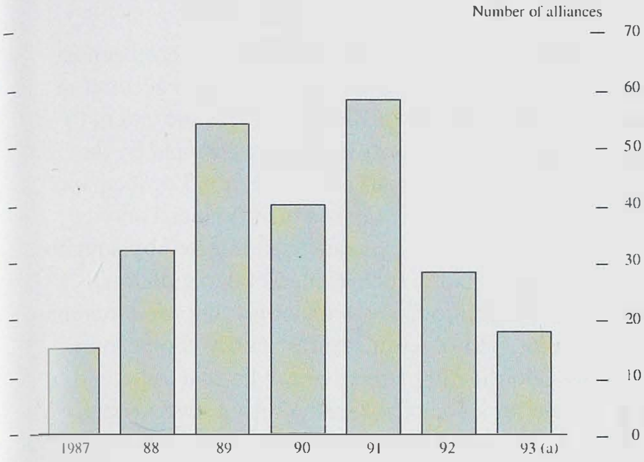
Chart 7
EC cross-border alliances in wholesale markets by type, 1987–93



EC cross-border alliances over time

Chart 8 shows the incidence of strategic alliances over time. It should be noted that figures for 1993 include alliances announced before 31 May only. From this it is clear that the majority of agreements (140 out of the 247) were made betweeen 1989 and 1991. There is no real pattern to the number of alliances by country over this period, although French firms were consistently more active than firms from other countries. What is perhaps surprising is the apparent decline in the number of alliances during 1992. As Chart 9 shows, a sharp slowdown in the activity from French firms (alliances dropped from 23 to 3) accounts for most of the drop in the number of deals, although activity from the UK firms also fell to 2 after a fairly consistent four-year run of between 6 and 9. This may be because of the economic

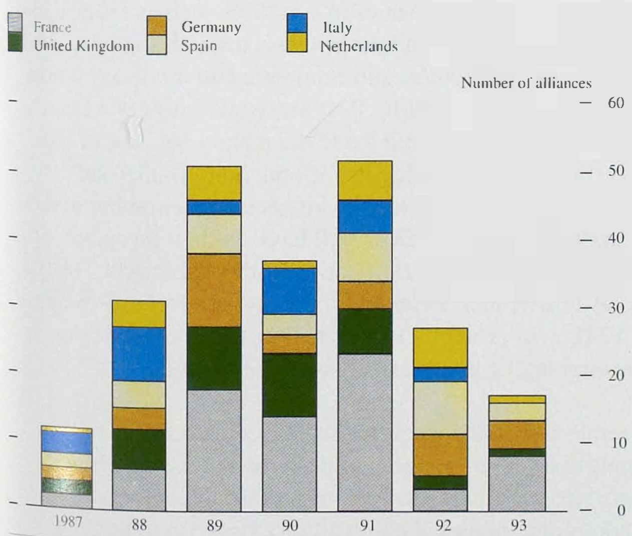
Chart 8
EC cross-border alliances, 1987–93



(a) Includes alliances announced before 31 May only.

slowdown in France and its effect on profits and capital generation, the lack of further suitable targets or simply because French firms have to a large extent completed their programme of expansion in the Community for the time being. It will be interesting to see whether, once the French

Chart 9
EC cross-border alliances by country, 1987–93



economy revives and the problems with the French property market and the recent large losses announced by some French banks are past, enthusiasm for alliances will re-emerge. The figures for the first five months of 1993 (showing 18 alliances) suggest that total activity for the year will exceed that of 1992 (27).

Bancassurance

The development of bancassurance (the provision of a full range of banking and insurance services by a single company or group) is a relatively recent phenomenon which, it had been assumed, would benefit from a fully integrated single market in financial services. However, of the total number of alliances studied, those between banks and insurance companies accounted for only 9% of the total. Institutions from France and Spain (see Chart 1) accounted for most of the transactions. The majority of transactions involving Spanish companies were joint ventures (examples include the agreements between Banco Bilbao Vizcaya and Groupe Axa of France and Caixa Bank and Fortis in the Netherlands), whereas French companies again favoured minority stakes. These two means of forming alliances between bank and insurance companies were by far the most common across all countries, probably reflecting the need of each partner for the skills and experience of the other. The Spanish and Italian markets appeared to be most targeted, reflecting the perceived opportunities for development in these markets. The evidence would appear to demonstrate that most cross-border bancassurance link-ups resulted from selective attempts to take opportunities in particular markets rather than general strategies to provide full bancassurance services.

The development of bancassurance has been controlled by supervisors', who have been keen to maintain a degree of separation between banking and insurance. Supervisors' concerns include the problems of dividing responsibility between bank and insurance regulators (as evidenced in the Netherlands with ING Bank), the manner in which firms manage risks on products which could be considered either as banking or insurance (eg export credit guarantees), and the potential for regulatory arbitrage on such products.

Since the supervisory regimes for banking and insurance are likely to remain significantly different for the forseeable future, a more attractive alternative to providing bancassurance through a single group may be to enter into marketing agreements whereby banks simply market insurance products which continue to be underwritten by unconnected insurance companies. A number of the alliances studied fall into this category.

In contrast to the low level of cross-border activity, there have been a number of developments linking major players in domestic markets including, in most countries, moves by banks to establish new subsidiaries or joint ventures to undertake insurance business. Examples include Lloyds Bank and Abbey Life in the United Kingdom, the merger of ING and NMB Postbank in the Netherlands and the various operations of the Compagnie de Suez group in France. The fact that bancassurance is a relatively new development and that firms have been fairly active in domestic markets may explain the lack of cross-border activity.

III Conclusions

The evidence that we have collected from published sources suggests that banks in the EC have been quite active in forging cross-border alliances in recent years. There are a number of distinct trends in the strategies adopted by financial institutions from different EC countries. According to our sample, French banks have been by far the most active, initiating 74 out of the 247 instances identified. UK, German and Spanish banks initiated respectively 36, 35 and 33 alliances. The 'target' companies were more evenly spread by nationality, with Spanish targets the most popular at 49 and UK targets totalling 39. Banks from the smaller EC countries have so far initiated relatively few alliances, but have, in contrast, been targets for considerably more. Despite the apparent attractions of 'bancassurance' for banks, only 22 of the identified alliances involved links with insurance companies. Firms from Germany and the United Kingdom appeared to prefer outright acquisitions or the taking of majority stakes to other forms of alliance, whereas French firms apppeared to favour minority stakes.

Many firms appear to have succeeded in identifying opportunities for cross-border acquisitions at an acceptable price. Looking behind the numbers it appears that a significant proportion of these opportunities have arisen where other institutions have withdrawn from particular markets because of their desire to focus on 'core' markets or where the company/unit being acquired has been performing poorly. In other cases the creation of joint-venture companies and formal co-operation agreements (eg to cross-market each others' products through their retail networks), often including some form of share exchange, have been seen as a more cost-effective option. This may suggest that initial concerns about limited access to foreign markets were not fully justified; on the other hand, very few of the transactions studied have provided a foreign institution with a major share of a core national market.

The analysis shows that relatively few strategic alliances appear to have been made specifically in order to develop business in wholesale markets, despite the fact that in this sector the barriers to cross-border alliances are much lower than in retail markets. This almost certainly reflects the fact that the markets have been international in character for several decades. In many cases, firms had the necessary structures in place to transact business in foreign markets well before the announcement of the single market.

In the retail sector, the single market does not appear, so far, to have removed the perceived barriers to cross-border alliances. These include the lack of availability of suitable distribution networks at prices attractive to acquisitive companies; continuing differences in language, customs and national regulations (eg accounting and takeover regulations); and continuing differences in fiscal measures (eg withholding taxes on different types of accounts, treatment of dividends in investment portfolios).

The pattern of activity may, of course, change significantly in the next few years. The single market process is still in its preliminary stages: it has only been in existence for a few months for the banking industry, and will not be in place for insurance or securities firms until 1994 and 1996 respectively. It seems likely, moreover, that the process of reviewing and then implementing strategies to respond to the opportunities of the single market by banks will take some time. Many banks will have taken strategic decisions in principle, and will now be waiting for suitable commercial opportunities to present themselves.

Although the approach of the single market has been an important factor which firms have taken into account in their strategies, it is still very difficult to assess the extent to which cross-border activity has been *prompted* by the approach of the single market. As Section I of the paper pointed out, the strategic decisions of financial service companies have for many years been affected by a number of other major factors, such as market deregulation, increased competition, new technology and the economic environment. However, measures such as the Second Banking Coordination Directive can be said to be responsible for some of the restructuring seen to date, even though it was only implemented from the begining of 1993: it put pressure on authorities to deregulate, both to ensure that they were competitive and to comply with its provisions, from a much earlier date.

A number of future developments will influence banks' strategic thinking. These include the implementation of further single market measures (the Capital Adequacy Directive, the Investment Services Directive and the insurance directives); further deregulation in national markets—in particular the privatisation of state-owned financial service companies in countries such as France and Italy; and, not least, further progress towards the integration of European economies and economic and monetary union. A recent report by KPMG Peat Marwick[1] suggested that few banks were prepared for EMU mainly because of the uncertainties surrounding its introduction. Banks had, in general, not yet begun to take into account a number of the profound effects that EMU will have on their business. It is quite possible that the ratification of the Maastricht Treaty by all 12 Member States and the entry into force of 'Stage 2' of EMU will prompt a further reassessment of strategies, and a resurgence of interest in cross-border activity.

Overall, it would appear that the expected benefits of the single market programme, as described in the Cecchini report (ie lower costs to consumers through more open markets and increased competition), have yet to be fully realised. However, with hindsight, it is perhaps more apparent that early expectations were themselves rather unrealistic, certainly as to the timing, and possibly as to the extent of the transformation that could be achieved within EC financial markets. Institutions are continuing to make acquisitions and establish co-operation agreements and, as noted above, a number of factors could yet lead to a resurgence of activity. It seems that, as in other areas of EC development, this process may take rather longer than its proponents had originally anticipated, but that in the end the single market programme may yet have a profound impact on the financial services sector within the EC.

(1) 'Consequences of ECU/EMU: a survey of the European banking industry', KPMG Peat Marwick, Paris.