European banking landscape between diversity, competition and concentration

HANS-HELMUT KOTZ AND DOROTHEA SCHÄFER

Hans-Helmut Kotz, Center for European Studies, Harvard University, Cambridge, MA, SAFE Policy Center, Goethe-Universität, Frankfurt a. M., e-mail: kotz@fas.harvard.edu
Dorothea Schäfer, German Institute for Economic Research DIW Berlin, CeFEO at Jönköping International Business School and CERBE Center for Relationship Banking and Economics, Rom, e-mail: dschaefer@diw.de

The consequences of diversity over a number of pertinent dimensions is often not adequately acknowledged in economics. As Reinhard H. Schmidt (in this issue) states: "*One could easily cite important recent research contributions with no traces of institutions and institutional differences of any kind and instead just one 'representative agent' living and operating in an institution-free idealized economic environment, an environment without any diversity.*" In reality, however, institutional variety, via its impact on incentives and cost of transactions, obviously has a defining bearing on economic outcomes. This perspective has been stressed by the new institutional economics. The relevance of institutional variety has also been acknowledged in finance (Allen and Gale 2000, Levine et al. 1999), this always held true for economic historians, here Gerschenkron is one of the best-known examples. In the "purer" domains of economics, however, for a long time, research revolved largely around the rather simplistic and binary comparison between bank-based versus market-based financial systems. The Great Financial Crisis has relaunched interest in the debate on the comparative efficiency of financial institutions (intermediaries as well as markets). Interestingly, whereas institutions betting on newfangled instruments fared badly, "boring" banks performed rather well. Of course, they could not escape second-round effects. But they have proven to be more resilient. This also held true at a systemic level. Here, institutional variety has apparently proven beneficial. Given this background, it is somehow surprising that, although the interest in the importance of institutional diversity for the functionality of financial systems has increased, research is still scarce and work on the topic is still pioneering. Therefore, the aim of this issue is to motivate and pave the way for more research on institutional diversity in banking and finance.

The volume starts with "Diversity in finance: An overview" on the different dimensions of institutional diversity. *Reinhard H. Schmidt* finds a decreasing within-country diversity in most countries of Western Europe as large, publicly owned and shareholder value-oriented banks have gained in

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importance at the expense of banks pursuing a broader, stakeholder value-oriented perspective. The between-country diversity has also declined as national banking systems have become more similar over time. Only in Germany and Austria within-country diversity has remained high. Schmidt identifies also substantial differences in Western European countries' financial systems despite a common trend towards a stronger capital market orientation. On a world-wide scale, between-regions diversity of financial systems is high and almost stable. Schmidt concedes that an overall assessment of dangers and merits of diversity is difficult to establish since we know too little about how differences in institutional diversity affect economic outcomes. However, he emphasizes that "*preserving diversity now is a protection against the risk of later not having something that one might later need even though one does not know now that one will later need it*".

Giovanni Ferri and *Doris Neuberger* explore the relationship between banking sector diversity and the two most important EU-wide regulatory frameworks for European financial sectors. In their work "How does banking diversity fit in the general vision inspiring the joint process of Banking Union and Capital Markets Union?" they identify the Global Financial Crisis of 2008/2009 and the Euro sovereign debt crisis of 2010/2012 as important drivers for EU-wide institution building. The authors claim, however, that experience made with both efforts calls for a reassessment and reform. In particular, Ferri und Neuberger discuss two unintended side-effects: the tendency of CMU to push financial systems toward market-based systems and the tendency of BU to weaken institutional diversity in the banking sector. They conclude that even if CMU and BU were economically successful, more effort is needed to align both frameworks with social and cultural goals that are an essential part of EU treaties.

Horst Gischer and *Christian Ilchmann* examine in their paper "Banking sector diversity and socioeconomic structure—criteria for matching pairs" whether and how the fit (or lack thereof) of the banking sector and the socioeconomic structure of a country are conducive to economic prospects. By applying a cluster analysis, the authors develop a coherent system of geographic, social and economic characteristics of real economies and assess to what extend EU banking sectors and real economies are "matching pairs".

Andreas Bley studies in his contribution "Limited diversity—business models of German cooperative banks" the degree of diversity within the German cooperative banking pillar. His empirical findings reveal a limited variety in business models applied across institutions. Almost all cooperative banks concentrate on the lending and deposit-taking business with customers. However, some degree of diversity is identifiable. Lending is the dominant item on the balance sheets of one group while in the other group deposits dominate. Bley stresses the importance of the proportionality principle in banking regulation and supervision in order to avoid further disadvantages for smaller institutions.

Franz Flögel and *Stefan Gärtner* present a study on diversity of the UK banking sector. In the work "Lost diversity—business lending in the centralized banking system of the UK", the authors classify the distance between lenders and SMEs in credit decisions for different types of lenders. They find that short distance lenders, such as local banks, have almost completely disappeared in the UK. This loss of proximity comes with costs in terms of access to funds. Therefore, they suggest restoring short distance lending in the country but concede that the running of regional banks is challenging in times of low interest rates and tightened bank regulation.

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Karl-Peter Schackmann-Fallis and *Mirko Weiß* remind the reader in their work "Post-financial crisis times: Only a short phase of re-intermediation and re-direction to boring banking business models? Regulatory burden, fintech competition and concentration processes" that some legislators expressed their will to restore the "boring" business model of deposit-based lending when the crisis peaked. The authors assess to what extent legislators have met this objective. They argue that the post-crisis regulation has increased the minimum bank size required for doing business in the banking sector and has initiated a wave of mergers, in particular among small institutions. In addition, policymakers rehabilitated loan securitization without providing an appropriate framework to avoid the inherent incentive to primarily securitize the more vulnerably and risky cash-flows. The authors conclude that the European Union's regulatory framework has so far turned out ineffective in allowing for or even fostering heterogeneous and small-scale market structures and in fostering business models focusing on deposit-based lending.

Mechthild Schrooten examines in "Finance and growth—shortly reconsidered" whether the paradigm of the 1980s and 90s, i.e. that financial development is a major determinant of economic growth and productivity in a country, still holds. This question is important given that the international crisis 2007/8 has clearly revealed the dark side of financial development and credit booms. In her empirical analysis, Schrooten focusses on post-crisis developments and finds that the finance-growth nexus has widely disappeared in the years after the crisis 2007/8.

Axel Bertuch-Samuels' work "Why we should embrace institutional diversity in banking" emphasizes the importance of institutionally diversified financial sectors for sustainable growth and financial stability. The author examines the factors which contributed to the successful evolution of the German savings banks and credit cooperatives over a period of more than 200 years. These factors of success are "*the concentration of their banking activities on a limited geographical region while working as a network of cooperating autonomous institutions, the prioritization of savings mobilization, a mandate to serve the economic and social well-being of the local region, while remaining profitable and financially viable over the long run rather than narrowly focusing on profit maximization*". The author emphasizes that those factors are crucial also for successful financial institution building and promotion of locally oriented microfinance and banking institutions in developing economies.

Lorenzo Bini Smaghi's article "What future for the European banking system?" provides a contrasting view on the question of what institutional structure the European banking sector(s) needs/(need). He explores the main factors underlying the decreasing profitability of European banks. Bini Smaghi emphasizes the disadvantage of European banks vis-à-vis US-based banks in terms of interest rate environment, concentration of banking markets, differences in regulation and supervision as well as the existence of a deep and liquid capital market. The author infers from his analysis that true pan-European banks and a true capital markets union are required to strengthen the European banking system.

The volume closes with a note by *Hans-Helmut Kotz* and *Dorothea Schäfer*: "Diversity across EU banking sectors: Poorly researched and underappreciated". The authors take empirically stock of the across country diversity of banking sectors in the European Union before and after the financial crisis. Subsequently, they assess diversity across a number of dimensions (competition/efficiency, stability and business models) and highlight key issues and open questions for a future research agenda for evaluating the importance of diversity in the banking and the financial sectors of the European Union. Given the substantial complementarity between finance and

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other societal sub-systems, they emphasize the topic's pertinence far beyond the financial realm. Therefore, this is also a debate with high relevance for a general public.

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