EUROPEAN

POLICYBRIEF

FINANCIALISATION ECONOMY SOCIETY AND SUSTAINABLE DEVELOPMENT

Structures of ownership in the financial sector

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INTRODUCTION

Structures of ownership

The analysis of the structure of ownership in the financial sector in the old and new EU Member States is particularly important for the proper understanding of the scale and scope of the process of financialisation in the EU countries. The importance of the structure of ownership in the financial sector of the EU countries comes in two ways. First, changes in the structure of ownership in the financial sector reflect the progress of privatization in many European countries, especially in the EU new Member States (NMS). This process manifests itself in a transfer of ownership of financial institutions from the State to the private sector. Secondly, the changes are a result of freedom of capital mobility in the whole EU. Consequently, both phenomena have a strong influence on the withdrawal of the State from the financial sector. This makes exerting the control over the functioning of the domestic financial institutions less focused.

The forms of ownership of financial institutions and types of financial institutions differ across the EU Member States. The structure of ownership in the EU financial sector is also influenced heavily by restructuring and privatisation processes, as they lead to consolidation and disintermediation, on the one hand breaking the traditional chain value while some functions are being fulfilled by new financial intermediaries, and on the other - decreasing the availability of funds for business and individual clients as a result of transformation of the financial markets into more oligopolistic ones.

Evidence and Analysis

Institutions in the financial sector across the EU

Over the past several years, the EU-27 credit institution population has reduced by circa 1000 institutions, resulting in just over 7800 credit institutions in 2012. The consolidation of the EU banking sector is a consequence of the Single Market, which promoted for the movement of capital across borders. The process of intensification of consolidation was also supported by large number of mergers and acquisitions. However, the EU market (except the United Kingdom) can be still described as based on a "bank-based" model as opposed to "capital markets-based" model. The ECB reports that share of banks in credit intermediation in Europe represents around 70%-75% of debt financing to households and enterprises.

Market concentration measured with the share of total assets held by the five largest institutions slightly increased in the last few years. Taking into consideration the individual Member States, the market concentration did not change much. Larger countries such as Germany, Italy and the United Kingdom still have more fragmented markets, whereas smaller countries, especially some new Member States, are characterised by concentrated banking sector. Although the framework for banking sector in the EU is constituted via harmonisation and mutual recognition rules, some differences in its structure can be noticed. In particular, these differences are evident while comparing the new and the old EU Member States. For instance, the level of financial intermediation is still low in the new Member States, as their financial sectors are concentrated and dominated by commercial banks. Foreign presence is also very large in most NMS: on average, more than 70% of bank assets are foreign-owned. At the same time, domestically owned banks from these countries have a limited presence abroad.

The EU insurance sector has been going through a period of rapid change, partly driven by the liberalization of insurance and capital markets and the harmonization of insurance regulation concerning supervisory control. The unification of insurance sector has intensified the competition of insurance companies and encouraged domestic as well as cross-border consolidation. Over the period 1992 to 2011, the number of companies in Europe evolved in two parallel ways. Between 1992 and 2000 there was an increase in company numbers in the accession countries in which the end of centralised economy and monopolistic or oligopolistic markets opened the way for foreign capital. The number of insurance companies in Europe declined as a result of the wave of mergers and acquisitions in the 1990s. However, these transactions have not always meant disappearance of the companies concerned. The groups constituted often retain the merged companies either for commercial reasons or by ceasing to underwrite new contracts but allowing them to manage old business.

The breakdown of insurance companies reveals that majority of them are national units, less than 15% are EU branches and less than 5% are non-EU branches. In most markets, domestic companies account for more than 90% of total premium income. This domination of domestic entities can be explained with differences in national legislation favouring the creation of domestic companies instead of branches. However, the capital ownership of domestic companies is widely spread across European shareholders.

There were around 3200 asset management companies in Europe at the end of 2012, offering more than 30000 mutual funds. The top three investment fund domiciles in terms of assets are Luxembourg, France and Germany, followed by the United Kingdom and Ireland. The strong market shares of France, Germany and the United Kingdom mirrors the size of the domestic savings market in these countries. Furthermore, the two largest countries in terms of discretionary mandate assets, the United Kingdom and France, managed 66% of total European discretionary mandates in 2011. The significant market share of the United Kingdom (47% in 2011) can be related to the status of London as an international financial centre, the very large base of pension fund assets managed there and the treatment of some pooled vehicles as discretionary mandates rather than investment funds. The European investment fund industry is dominated by large players across countries. The top five asset managers in each of the largest domiciles for investment funds in Europe (France and the United Kingdom) control half or less of the total market. On the other side of the spectrum, in Germany the top five asset managers controlled 90% of investment funds at end of 2011.

The ownership structures in the EU financial sector

Another dimension of the ownership of the European asset management industry is the extent to which asset management firms operate as stand-alone companies, or form part of financial services groups. In most European countries, banking groups represent the dominant parent category, controlling at least half of all asset management companies. The main exceptions to the bank-dominated model are France and the United Kingdom. In the United Kingdom, only 18% of asset managers are owned by banking groups, with insurance groups controlling 15%. In France, the majority of firms represent independent asset managers. Banks retain ownership of 23% of asset managers and insurance companies consist of 7% of total asset managers as the majority of firms consist of small independent asset managers.

The largest 35 financial institutions in the EU 27 with total assets exceeding EUR 500,000 million are almost all in private hands. Main foreign countries or regions, in which these 35 institutions operate, cover mainly other EU Member States, with presence also in the United States, African and Asian countries.
The majority of foreign institutions operating within the EU is present in Great Britain. Global ultimate owners of these foreign institutions are investment banks from the United States, Japan and Switzerland. The vast majority of banks' assets in the EU is controlled by the EU shareholders with British (nearly 30%), French (24%) and German (nearly 14%) investors at the first place. The old EU Member States account for 94% of the total assets of the 100 biggest banks in the EU. The largest EU insurers are, in general, owned by domestic investors. However, often insurance companies are a part of larger financial conglomerate, whereas the largest EU insurers are cross-border undertakings. Shareholdings in the largest insurance companies is rather dispersed, as these large insurance

companies are publicly listed. In some cases, major shareholders hold preferred shares. In others, almost all shares continue to be held in a free float.
Differences in the ownership structure of largest banks in different EU countries are more ambiguous. Leaving mutual and public banks aside, it is clear that ownership of largest banking institutions is linked with corporate control mechanism on which financial system is based. Data on the ownership of large banks from the continental Europe partially support this assumption, maybe except for German Deutsche Bank, which is characterized by high dispersion of the shareholdings. On the other hand, in the United Kingdom, in which the outsider model of corporate control depending on the market as a primary source of control dominates, shareholding is as would be expected.: largest institutional owners control very low stakes in the Royal Bank of Scotland and Lloyds Banking Group. It should be noted, however, that large banks tend to become similar to each other evolving in ways not fully compatible with either insider or outsider models. While the ownership of some banks is dispersed the stakes controlled by the largest shareholders are high (Standard Chartered). However, in other banks ownership is rather concentrated but distinguishes itself with low stakes of the largest shareholders (Danske Bank, Banca Monte dei Paschi Siena).

It is notable that the market concentration measured in terms of total assets is highest in the new EU Member States. In Poland and in the Czech Republic the largest ten banks account for 72% and 82%, respectively, whereas in the United Kingdom, France and Germany the share is 62%, 70% and 58%, respectively. However, in smaller old EU Member States with lower number of banks the largest institutions have a larger market share. Thus, in Greece the top 10 institutions have the highest market share, i.e. 95%, followed by Sweden with 89% share of top 10 banks.

Foreign ownership from the EU is very high in the new EU Member States along with the limited State involvement. Unlike the old EU Member States, domestic investors are hardly present among shareholders of Polish, Hungarian or Czech banks. In the Czech Republic, banking sector is almost completely dominated by foreign capital, whereas in Hungary and Poland only some specialized agency remain under the control of the State. The presence of the State is more significant in highly developed economies, for instance in Germany or Sweden.

What is interesting is the fact that the State acting as a direct ultimate shareholder among the 10 largest banks is almost absent in Italy and France.

Analysis of the share of institutions controlled solely by the State, in the total assets of the banking sector leads to somehow different conclusions. The share of the State is the lowest in the United Kingdom and the highest in Germany.

The ownership pattern in the United Kingdom is based on limited influence of public authorities on the banking sector, which is exerted almost only via one specialized agency. This agency is the National Savings and Investments. However, the involvement of the State in British banks rose in the aftermath of the global financial crisis, although this state of affairs is expected to be only temporary and aimed at restructuring of endangered banks.
In Germany the public authorities are active players in the banking sector, exerting control over large number of entities which fulfil different functions. The involvement of the State in German banks is high. The ownership structure is concentrated and the largest investors control significant block holdings.

Ownership structures observed in the remaining countries can be located somewhere in between. For instance, in France the State is present almost solely in various special-purpose entities that fulfil socially desirable targets. The involvement of State in the banking sector, measured as the share of publicly controlled assets in the overall assets, is small. French fully public companies are municipal credit banks with no significant market share: Banque Postale and the Caisse des Dépôts et Consignations. The French pattern remains close to these observed in Sweden and Greece. In these countries the State is present in the banking sector through specialized agencies as well – supporting financing of municipalities (Kommuninvest in Sweden) or international trade (the Export Credit Insurance Organisation in Greece and Swedish AB Svensk Exportkredit). The shareholdings in these countries is rather concentrated and the largest investors control significant stakes in banks.

Italian banking system distinguishes itself with relatively dispersed ownership as the number of investors controlling banks is higher than in other continental European countries and stakes owned by the key investors are smaller. Public ownership is centred only in specialized agencies such as savings institution Cassa Depositi e Prestiti.

Consolidation and privatization and their impact on the structure of ownership of financial institutions in the EU

A different structure of ownership has evolved in the NMS. Banking sectors of these countries are dominated by foreign banks and the public involvement is limited. The ownership of banks in these countries is highly concentrated and number of shareholders in particular banks is low. In many cases the largest investors control more than 50% of votes and some institutions are owned solely by one foreign investor – parent bank. The overall ownership pattern is not homogeneous in the NMS, however. Whereas the patterns observed in Hungary and the Czech Republic, apart from higher involvement of the State in the banking sector in Hungary, are similar to each other, the ownership structure of banks in Poland is somehow different. In Poland the State has significant influence on the banking sector due to the unfinished privatization process, as the government controls dominating stake in the biggest bank in Poland (PKO Bank Polski). The worsening fiscal situation and the rise of deficit of the public sector can trigger the privatization off once again, however. This may lead to further decline of the State involvement in the Polish banking sector, thus moving the ownership pattern closer to the one observed in Hungary and the Czech Republic.

The merger and acquisition activity of the EU financial institutions now appears to be the most intense in the banking sector, as the process of consolidation of the European insurance sector has already been accomplished with the EU insurance groups more internationally oriented than banks. These latter institutions appear to have a home bias, whereas insurance companies have a foreign bias, earning majority of their revenues in host countries, primarily in other EU Member States. The cross-sector merger and acquisition (M&A) activity between the EU banks and insurance companies and/or asset management firms has also diminished, being characterised by a small number of transactions.

Significant transactions in the EU banking sector took place in the second half of 1990s. The first wave of transactions resulted from developments associated with German unification, whereas the second one from the creation of the Economic and Monetary Union. However, in this period M&A activity involved domestic consolidation, mainly between smaller institutions with assets of up to EUR 1 billion, except for a few regional cross-border deals, as third countries, other than EU states, were more common targets. In 1993-2003, the number of M&As involving domestic credit institutions represented about 80% of total volume of M&A deals in the whole EMU. Apart from 1992, when cross-border M&As increased in the run-up to the Single Market, the share of cross-border operations was always significantly lower than this of domestic operations. Then, following a decline in the 2000-2002, an increase in the value of M&A was observed, mainly due to drying up of domestic markets and intensification of cross-border M&A. Developing cross-border activity was expected to strengthen competition, forcing at the same time inefficient domestic banks to improve their financial situation.

Since 2003 cross-border M&As have been increasing, both in absolute and relative terms, achieving a record high value in 2005. This was the only year in which cross-border transactions accounted for more than half of the total value of M&As. This outcome was accomplished mainly due to exceptionally large mergers such as Unicredit and HypoVereinsbank. After 2005 the importance of cross-border M&As in the EU remained significant. However, with the exception of 2005, domestic M&As dominated the total M&As' value. The year 2006 saw also another large international deal, as French BNP acquired the Italian group BNL. In 2008 the value of cross-border M&As was affected by the acquisition of ABN Amro by the consortium of Royal Bank of Scotland (RBS), Fortis, and Santander. The number of M&As in the EU dropped in 2008 in the aftermath of the global financial crisis. M&A activity started recovering in 2009, with the fastest increase in the sector of domestic deals.

Analysing the current M&A activity in the EU Member States cross-border consolidation has two diverging trends concerning the ownership of financial institutions' assets. These trends were labelled by ECB as “inward Europeanization” and “outward Europeanization”. For instance, in the British and Luxembourgian banking sectors the dominance of the “inward Europeanization” can be observed, since the total assets held by the EU banks in these countries are higher than the total assets held by British and Luxembourgian banks in the EU. In contrast, in Italian and Spanish banking sector “outward Europeanization” dominates, as well as – but to the lesser extent – in French, Dutch, Belgian and Swedish banking sectors. Finally, German banking sector is an example of sector in which both trends appear to have similar potential as the gap between the domestic-owned assets in other EU countries and domestic assets owned by banks from other EU countries is relatively small.

As a result of cross-border consolidation, foreign subsidiaries have increased their market share. The cross-border activity is weak in traditional financial hubs, particularly in the United Kingdom, Luxembourg and Germany. At the same time, the opposite phenomenon can be observed in the NMS. Significant differences can be observed in the level of internationalisation of the banking sector in the old and new EU Member States. In the old EU Member States foreign entities usually account for less than 30% of total banking assets.

Two main factors have influenced the cross-border M&As activity in the NMS since 2008. Firstly, expansion has not been considered a priority by banks during global financial crisis, as they have faced significant losses and have focused on refilling their capital reserves. This has limited abilities to develop activities in other sectors and regions. Secondly, a significant shift in the ownership structure in favour of public authorities have appeared in some banking sectors as transfer of several banks endangered with bankruptcy to temporary State ownership has been chosen a stabilization option. Many European banks were bailed out by their national governments. Financial institutions, searching for public help, had no choice but to accept terms of this support. These terms include among others divesting supported banks' foreign-owned assets.

Privatization is the driving force behind changes in the ownership structure of financial institutions in all CEECs. The denationalization process in CEECs was the deepest in the banking sectors, with the privatisation programmes involving a massive sell-off of formerly state-owned banks to foreign investors. As a result, foreign banks became very active in the new EU Member States in the second half of the 1990s. In 1998-2002, a large number of M&A cross-border deals were concluded as this was the time of the most intense privatization programmes as they had been completed only until the beginning of this century. The value of M&A deals, however, was very much below the EU-15 average. This was due to the fact that banks in the NMS were generally small in terms of asset size. Only in the Czech Republic, Hungary and Poland were there a few larger institutions, which were also privatised.

Privatization of the banking sectors of the new EU Member States resulted in reduction in costs and margins for domestic banks by increased competition. Privatization was also accompanied by the improvements in the financial infrastructure, both stimulating the growth and development of foreign banks as well as surviving domestic ones. This rapid opening of banking sectors of the new Member States may have had negative consequences. Institutional infrastructure was not developed fast enough to protect the sustainable development of their banking sectors. Quick privatization accompanied by competitive advantages of foreign banks has led to the establishment of the monopoly of foreign banks in the new EU Member States. This threat is even more severe as one of outcomes of the privatisation process has been a drastic decline in the State ownership of banks. But when institutional quality is poor, as it is some new EU Member States, nonexistence of the state-owned financial institutions may lead to financial disintermediation as only state-owned banks would support clients' confidence in whole financial sector financial system when economic circumstances are inadequate for private banks to play their developmental role.

The privatization process and control exercised by foreign banks, mostly from the old EU Member States, created a background for establishment of banking groups and financial conglomerates. The establishment of foreign ownership of banks resulted in fast development of banking sectors of the new EU Member States allowing for quicker catching-up with standards common in advanced economies. However, a pressure from narrowing margins resulting from intense privatization and mounting competition in the banking market in the NMS may lead to the need to further expansion of activity of foreign banks. This may result in new wave of M&A deals in the NMS, creating a background for even stronger consolidation in banking sectors of these countries and thus enforcing oligopolistic structure in their banking markets.

Policy Implications and Recommendations

The evolution of ownership of financial institutions across the EU is closely linked with the prevailing corporate governance mechanism. In countries in which financial system has developed on the basis of outsider model, less concentrated shareholding, without large institutional investor controlling blocks, is the dominant form of ownership. On the other hand, countries in which financial system has evolved within the framework of close links between management of financial institutions and large investors, exerting control over majority of votes in the annual shareholder meetings, ownership is more concentrated and focused.

Ownership patterns are characterized by high inertia. Despite that, some tendencies in the ownership of financial institutions have been observed since the creation of the Economic and Monetary Union. Adoption of common currency, along with globalization and intensification of capital flows, has fostered the process of integration of European financial markets, resulting in intensification of market competition and consolidation of financial institutions. This has influenced corporate governance, as its mechanisms in many European countries have started implementing "market-oriented" elements, resulting in creation of more market-based insider models. On the other hand, in outsider models the increasing role of shareholders has been observed, partially due to amendments to European law encompassing, among other, the Takeover Directive. As a consequence of these both phenomena in the long run pure insider and outsider models may vanish, whereas existing models of corporate control would transform into more interim solutions. Eventually corporate governance mechanisms and ownership patterns may become more consistent and homogenous across Europe.

This process poses some challenges especially to regulatory authorities. Increase in similarity of corporate governance mechanisms and models would make large financial institutions in different countries resemble each other. This would lead to business strategies of multinational financial companies more similar to strategies of global investment financial institutions, engaging mainly in international flow of capital and thus limiting the fulfilment of their core functions, such as gathering domestic savings and transferring them into loans to institutional and individual clients. This strengthening tendency may decrease the stability of the European financial system.

There may be further growth of already large financial institutions, leading to growing consolidation and concentration in financial market. This may in turn limit competition, increasing and/or petrifying oligopolistic market structures, resulting in less choice and higher prices. Such developments would be especially dangerous in the NMS, as their financial markets are already dominated by large financial groups, often focusing only on the most profitable services and pushing out local institutions out of these segments of market. Moreover, growing interconnections between foreign subsidiaries belonging to the same parent groups increase the risk of cross-border contagion as well as the risk of withdrawal of capital from financial sectors of the NMS. Concentration in the financial sector accompanied by web of cross-ownership linkages is dangerous also for the old EU Member States, as it may intensify systemic risk related to “too big to fail” and “too many to fail” problems. This threat stems from the fact that decision-making centres of large financial institutions are located within the old Member States, so authorities of these countries are those that have to interfere in the functioning of large financial institutions at times of disturbances in financial markets, taking it upon themselves to provide these institutions with public financial help at the expense of taxpayers if necessary. These issues are impossible to be addressed at the national level.

The presence of financial institutions from the old EU Member States in the new ones poses additional problems. Undoubtedly large foreign financial institutions provided banking sectors of the NMS with additional capital, managerial know-how as well as a vast array of innovative financial services of high quality. As a result, they have positively contributed to competition and efficiency of the local markets. On the other hand, fast and sometimes uncontrolled drive towards privatisation of formerly State-owned financial institutions upset the development of their financial sectors. The current structure of the financial sector in the NMS has been the outcome of privatisation policy, focused on attracting foreign strategic investors in the short period of time in the face of the lack of domestic capital, not the outcome of market processes. The consequence is the predominant foreign ownership of financial institutions in most NMS, supplanting the State ownership, sometimes almost completely. However, international financial groups base their activity on the assessment of the situation of the financial group as a whole. Liquidity tensions in parent financial group may limit the financial intermediation activity undertaken by its subsidiaries or branches or demand higher premiums for keeping it at unchanged level. As a result, host countries may suffer for instance from higher prices or from the squeeze of credit activity of financial institutions, resulting in increase of the volatility in the domestic debt and credit markets. Foreign-owned institutions are less committed to host countries than domestic-owned institutions, so at times of huge financial disturbances they may simply close branches and subsidiaries in host countries in order to cut losses.

Research Parameters

The research programme will integrate diverse levels, methods and disciplinary traditions with the aim of developing a comprehensive policy agenda for changing the role of the financial system to help achieve a future which is sustainable in environmental, social and economic terms. The programme involves an integrated and balanced consortium involving partners from 14 countries that has unsurpassed experience of deploying diverse perspectives both within economics and across disciplines inclusive of economics. The programme is distinctively pluralistic, and aims to forge alliances across the social sciences, so as to understand how finance can better serve economic, social and environmental needs. The central issues addressed are the ways in which the growth and performance of economies in the last 30 years have been dependent on the characteristics of the processes of financialisation; how has financialisation impacted on the achievement of specific economic, social, and environmental objectives?; the nature of the relationship between financialisation and the sustainability of the financial system, economic development and the environment?; the lessons to be drawn from the crisis about the nature and impacts of financialisation? ; what are the requisites of a financial system able to support a process of sustainable development, broadly conceived?

PROJECT IDENTITY

PROJECT NAME	Financialisation Economy Society and Sustainable Development (FESSUD)
COORDINATOR	Professor Malcolm Sawyer. University of Leeds, UK. Email: fessud@leeds.ac.uk
CONSORTIUM	University of Siena, Italy School of Oriental and African Studies, UK Fondation Nationale des Sciences Politiques, France Pour la Solidarité, Brussels, Belgium Poznan University of Economics, Poland Tallin University of Technology, Estonia Berlin School of Economics and Law, Germany Centre for Social Studies, University of Coimbra, Portugal University of Pannonia, Veszprem, Hungary National and Kapodistrian University of Athens, Greece Middle East Technical University, Ankara, Turkey Lund University,Sweden University of Witwatersrand, South Africa University of the Basque Country, Bilbao, Spain
FUNDING SCHEME	FP7 Socio-economic Sciences and the Humanities, topic for SSH.2010.1.2-1, ‘Changing the role of the financial system to better serve economic, social and environmental objectives’
DURATION	1st December 2011 to 30th November 2016
BUDGET	EU contribution: 7,923,728.02 euros
WEBSITE	fessud.eu
FOR MORE INFORMATION	Helen Evans: fessud@leeds.ac.uk
FURTHER READING	List up to five current or forthcoming publications the project has produced that might be of interest to policymakers.