

Banques italiennes : dix ans de révolution

L'Association professionnelle des banques italiennes retrace, à travers un guide qu'elle vient de faire paraître, les principales évolutions et réformes qu'a connues, ces dix dernières années, le système bancaire italien. Extraits.

Associazione Bancaria Italiana
ABI

■ The Italian banking system has changed both in terms of its characteristics and in terms of its nature. It went through a profound transformation a true revolution that finds no equal in other European countries.

The pages that follow provide a snapshot of the changes and the took place in recent events that years.

The state owned banks that once existed are no longer a feature of the Italian banking system. The sector is characterized by fewer, larger, privately controlled banking groups that are in fierce competition with each other. Vying with each other for both market share and clients in terms of efficiency and innovation, as well as in terms of the variety of services offered. Most of them are listed on the stock exchange.

The increase of quality and quantity of the services on offer to clients goes hand in hand with the strong growth in loans, figures and in terms of the conditions available to the clients. Competition has also brought about a stronger monitoring of operating costs.

The process of mergers and acquisitions that took place in these years reduced the overall number of banks (from over a thousand in the 1980s to just over 800 now, belonging to only 150 independent groups) and boosted their growth: the average size of the largest banks has doubled in nine years to 160 million euros. The efficiency gap with other European countries has also been progressively reduced as a result of these processes.

As a result, the Italian credit system is now based on larger, more complex and increasingly profitable banking groups that have proven themselves able to accompany households and companies along their investment paths in times of economic uncertainty.

The analysis that follows outlines the most salient points of the revolution that in ten years redesigned the Italian banking sector, focusing on the results achieved. The time period being examined and the outcome of the process, albeit far from over, represents an important chapter in the recent history of the Italian credit system and that of the Italian economy.

A system radically changed in ten years

The dynamic process of mergers and acquisitions that Italy underwent has led to fewer banks larger in size. Almost all of them have shed their state ownership and many are publicly traded thanks to an intense process of privatizations and public offerings. The changes in the Italian banking system of the last ten years find no parallel among its European counterparts. Whichever way one looks at the evolution of the Italian financial system, the outcome cannot be judged but positively. The shakeup, which led to an increase in the system's overall efficiency as well as to a rise in competition, bolstered both the solidity and the profitability of Italy's credit institutions thanks to the enlarged range of services as well as a

constant monitoring of costs. The services on offer to clients in terms of quality, quantity and conditions applied have risen hand in hand with the expansion of the sector's financial activities.

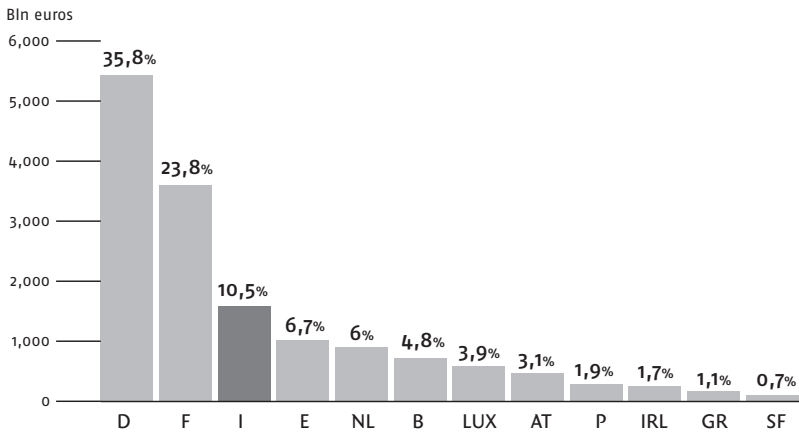
The Italian banking system has 10.5% of the total banking assets of the 12 nations sharing the euro, lagging behind only Germany and France.

The numbers describing the transformation of the Italian banking sector speak for themselves. The number of banks operating in Italy dropped 24%, from 1,069 in 1980 to 814 in 2002. Of these, only 150 are independent.

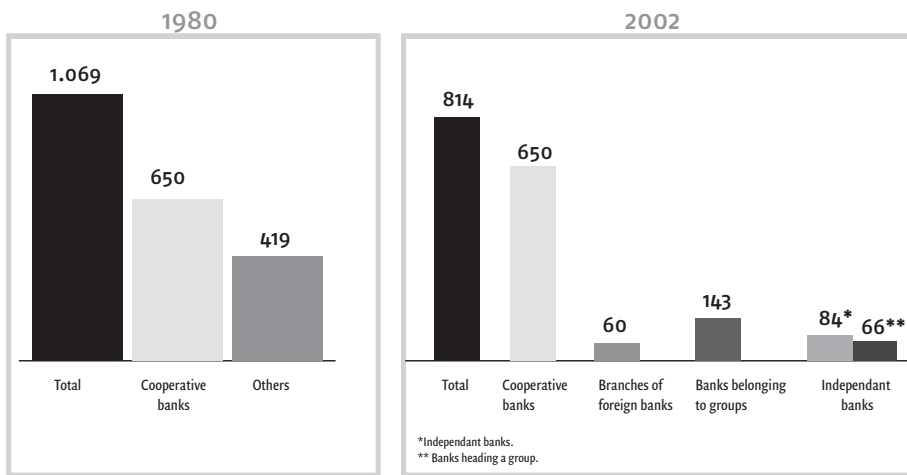
As a result, the average size of Italian banks has increased strongly. In terms of individual credit institutions, the average size of the three largest Italian banks almost doubled to 159.3 billion euros in 2002 from 80.1 billion euros in 1993. Greater still was the increase in size of the three largest banking groups, that climbed in the period to 232.6 billion euros from 95.9 billion euros. And the quantum leap is not limited to top ranking lenders. The scenario is identical when looking the nation's ten largest banks, in which case assets grew to 95.3 billion euros in the period from 56.7 billion euros, or the top 10 groups, the assets of which rose to 122.8 billion euros from 65.0 billion euros.

The value of banks traded on the Italian Stock Exchange has grown in recent years, reflecting the changes taking place in the system. While in 1993 the book value of the 21 banks listed on the 'ristretto' market and the 20 on the offi-

Total banking assets in the euro zone (2001)



Number of banks in Italy



cial exchange was 29.7 billion euros, by the end of 2002 the value of the 6 banks on the 'ristretto' market and the 35 listed on the official market had surged 165% to 79 billion euros.

At the end of 2002, 60% of Italian banks were listed, compared with 37.3% 9 years earlier. The market value of banks listed in Italy totaled 98 billion euros at the end of last year, making up almost a quarter (22%) of the Italian Exchange's total market capitalization.

These developments were the outcome of an intense process of mergers and acquisitions that took place in the 1990s and revolutionized the Italian banking sector.

In terms of assets, it came second only to a similar process that took place in Germany. If the actual number of banks involved is calculated, then Italy tops the rankings. The Italian banking sector's relevance as a case study becomes even more important when the acquisition of majority stakes is taken into account as well as actual mergers. Between

1990 and 2002, 583 such transactions took place, a number equal to more than half of the banks that existed in 1990 and more than 70% of those operating in 2002. The result doesn't change if total assets are taken as a measurement; in the last decade, consolidation involved more than half of the Italian banking system.

The two tier integration process of the 1990s served to craft the Italian banking sector into its current, more efficient shape. The first phase ended in May 1997 was characterized by rescue operations aimed at salvaging problematic situations as well as by the rationalization of niche players and by the gaining of footholds in geographical areas by players of all sizes to boost their scarce presence. The second phase, which began halfway through 1997 and lasted for three years, was dominated by mergers and acquisitions mainly among the nation's larger banking groups. The latter part of the process was geared mainly towards creating a limited number of effi-

cient and competitive players active both in the traditional businesses of Italian banks as well as in the field of innovative services.

So the integration process was a two faceted one. In stage one, problematic banking realities were consolidated and cleaned up, while the distinctive features of the second phase were the marriages that took place among the larger players, aimed at improving the banks' accounts. The transformation of the banking system in the United States had followed a similar path a few years earlier; there, the first phase occurred between 1980 and 1992 and phase two started in 1993.

Two peaks in Italian banks' merger and acquisition activity can be identified during the 1990s. The first took place in 1995, with 66 transactions (19 acquisitions of majority stakes and 47 mergers), crowning three years of heightening activity starting from 1992. Four years later, in 1999, there were 64 transactions (28 acquisitions and 36 mergers) that took place at the peak of the second phase of the restructuring process.

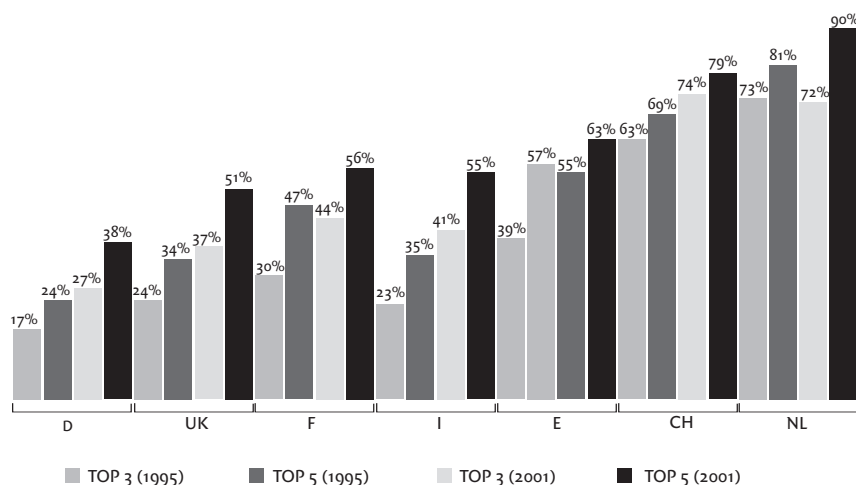
The evolution is also significant by comparison with similar ones taking place in other European countries. In absolute terms, the number of Italian banks decreased more slowly than those in Spain, France or many. But if Italy's 461 cooperative banks (Bcc) (that offer clients many product lines originating from their central institute) are taken as a single entity, then at the end of 2002 the Italian banking system was made up of only 70 banking groups that controlled about 90 % of the market while and 84 independent credit institut with no ties to the groups.

Still by comparison with its European peers, at the end of the restructuring process Italy ranked fourth terms of number of banks active in the country. At end of the first half of 2003, 6,776 banks were operating in the 12 nations sharing the single currency, 90 % of which originated from the euro region. Germany topped the rankings with 35% of total banks, followed by France and Austria with 14% and 12% of the banks active in Europe. Italy came close fourth with 11.9%.

The Italian banking sector has also grown in terms of its largest banks. In 1995, the nation's five largest banking groups generated 40% of Italy's total banking activities and was below most of

Banking concentration in european countries

(Share of biggest banking groups as a % of total assets)



the countries of the European Union.

In 2001, Italy's five biggest groups were responsible for 55% of the nation's total banking activity, a proportion far closer to that of countries such as France and Spain and above Germany and the United Kingdom.

The powerful integration process overhauling the Italian banking system also served as a stimulus per competition. A recent study carried out by Ente Eindudi on commercial banks and competition between 1995 and 2000 in Italy and in the euro zone concluded the sector to be competitive in both markets.

An additional effect of the restructuring process in Italy was to put pressure on costs, which were originally much higher in Italy than in other European countries. Furthermore, the efficiency differential, which in the mid-1990s was still very high at about 20%, had almost disappeared by the end of the decade.

Particularly striking evidence of the vitality of the process was the move that took place in the sector from State controlled towards private ownership. In 1990, before the Amato banking reform (issued with the aim of transforming savings banks into joint-stock companies and separating state-owned entities and banks) nearly 75% of banks were still state-owned the highest proportion in Europe at the time. By 2002, the percentage had fallen drastically to less than 1%.

One of the factors that spurred the modernization of the Italian banking system in the 1990s was the completion of the regulatory framework within which financial services companies operated.

The new laws and regulations liberalized Italy's financial markets, eliminating many obstacles that had been a hindrance to their efficient functioning. This had been aided by the implementation of two European banking directives between the 1980s and the 1990s.

The positive effects of the new market regulation

In 1990 a series of events took place that were of fundamental importance to the development of Italy's banking industry. An antitrust law was passed, promoting competition in the banking industry, the opening of bank branches was liberalized, and the Amato law was passed in a bid to stimulate the savings banks to turn themselves into joint-stock companies and incentivate banking mergers.

The new regulatory framework was further developed in coming years, and in 1993 Italy codified its banking legislation in the so called 'Testo Unico banca-

Changes in italian regulation

Implementation of European banking directives

1980-1990	(Directive 77/780 - Law 74/1985 Directive 89/646 - Law 481/1992)
1990	Liberalization of bank branch openings
1990	New regulation aimed at boosting competition in the banking sector
1990	Law encouraging the transformation of savings banks into joint-stock companies and incentivating mergers (Amato law)
1993	Testo Unico bancario
1998	Testo Unico della finanza

rio' (Tub). The outcome was a major break from the past, being the first major overhaul of Italy's banking legislation to have taken place since 1936. Until then, banks could either operate as a short term credit institutes or as entities specializing in long term lending. The new legislation removed the barriers between short term and medium/long term credit banks. In addition, it abolished the legal difference between banks of national interest, public law banks, popular, savings and rural banks as well as special credit institutions. Currently, Italy's legal system only recognizes two forms of banks joint-stock banks and cooperative ones. The new legislation also laid down the rules governing the relationship between the Italian banking system and the industrial sector. In fact, the Bank of Italy has to approve any purchase of over 5% of a bank by a non financial company. The regulations also limit latter's holdings in banks to 15 %.

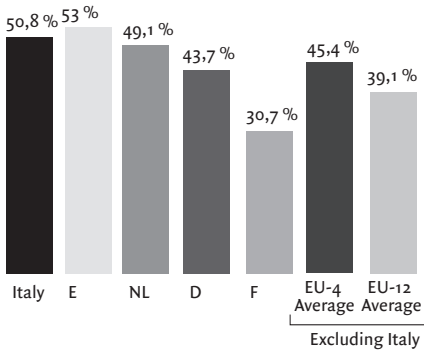
In 1998 the regulatory framework was completed with the called 'Testo Unico della finanza'.

Households and firms have more credit at better conditions

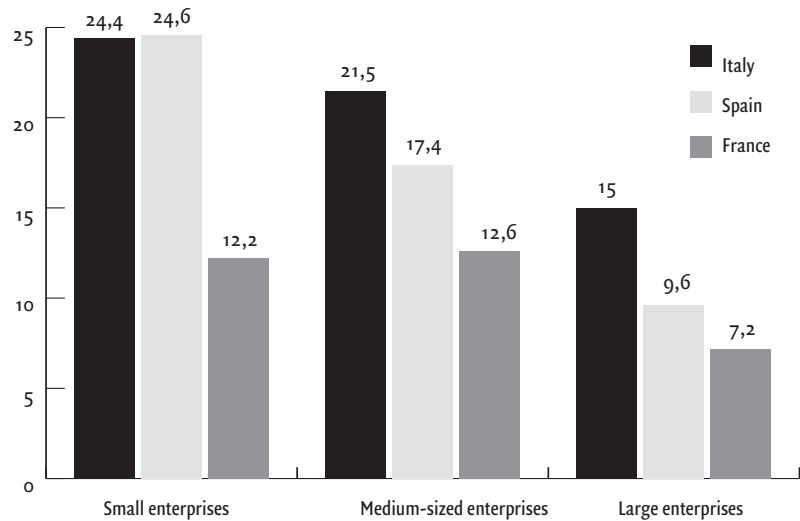
Italian bank loans to families and companies have enjoyed a constant growth rate in the last few years to the benefit of clients, who were able to benefit of better financing conditions thanks to the increasing competition. One not very well known but startling figure that illustrates the dynamic of credit growth in Italy in the period is the following: at the end of the first half of this year, the ratio of bank loans to banking deposits and bonds was 110.4%, almost 30 percentage points above the euro zone average of 84.3%. Data on the last few years of activity show the constant pace at which loans have grown. Bank loans as a percentage of Italy's gross domestic product rose to 77.9% in 2002 from 67.8% in 1999 and 59.8% in 1995, posting rises in all the years in question.

Among the largest European countries, Italian banks, whose loans in 2002 totalled 50.8% of total assets, came second only to Spain's 53%. In France and in Germany, bank

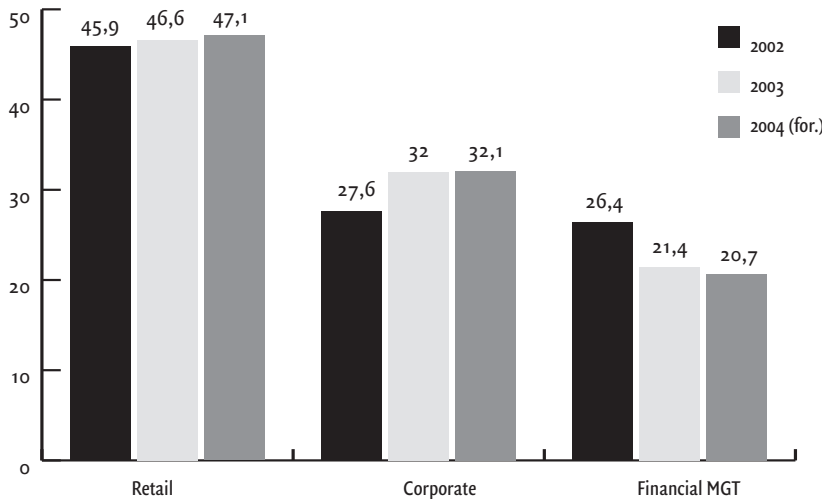
Loans as a percentage of total banking assets



Bank loans as a % of total company liabilities in Italy, Spain, France



Composition of banking margins per business area



loans were 43.7% and 30.7% of total assets respectively.

Changes in Italy's banking services scenario aren't just limited to the quantity of credit available. It is the qualitative aspect and the tight links the banking world has with small and medium sized firms that characterize the recent evolution. This can be clearly seen in the way loans have been distributed among different players in Italy in the last few years. When compared to European data, more Italian loans go to enterprises than families, both as a proportion of the whole and on average. At the end of the first half of 2003, loans to Italian firms were 65.5% of total credit, compared with an average of 47% in the euro zone. Loans to families totalled 34.5%, compared with an average of over 50% in the single currency area.

A series of other indicators highlight the link between Italian companies and their banks. Bank loans averaged about 61.8% of Italian companies' total liabilities in 2001. On average, the smaller the firm, the higher the proportion of bank loans: from 53.7% for firms with more than 200 employees, rising to 75.6% for those with fewer than 49 employees.

Small and medium sized enterprises in fact take out a very large proportion (49.8%) of total bank loans.

The amount of attention Italian banks pay to domestic companies is evident when it is compared to that of similar banking systems in Spain or France. Bank loans as a percentage of the total debt of large and medium sized companies in Italy is above that of their Spanish and French counterparts. Only when it comes to smaller sized busi-

nesses does Spain reach Italian levels. This phenomenon needs to be considered in conjunction with the 'structural' explanation for these proportions. Italian firms lag their Spanish counterparts in terms of capital adequacy as a proportion of total debt.

The always increasing attention banks pay companies' needs is also having profound effects on the way the credit institutions are organized internally and on the relative weights of the different business divisions.

Retail banking contributes significantly to total banking revenue at Italian banks. It generates about 47% of gross income. The corporate sector posted the most significant growth rates and will rise to 32% of gross income in 2004, from 27.5% in 2002. The remaining 26% is attributable to other areas of business such as financial management (i.e. revenue from securities, shareholdings, and the inter bank market) and is expected to drop to 21% at the end of the period.

The trend appears set to continue. Corporate finance is estimated to rise to 20% of total banking revenue by 2004, boosting the contribution of corporate banking to overall banking activity.

So, what were the concrete effects of the important process of mergers and the consolidation that took place in the Italian banking sector in the 1990s? The answer is: increasingly efficient banks that are operating in a more competitive market in a way that hasn't sacrificed profitability.

Increasingly efficient and profitable banks

The improvement in efficiency is reflected in two indicators; the incidence of the cost of labour and that of operational costs on intermediated funds. Both have experienced noticeable reductions, arriving at levels close to European averages. The gap between the labour productivity of large Italian banking groups and that of their European counterparts fell between 1996 and 2001, according to an analysis carried out on 150 financial institutions. The differential fell to 7.4% in 2001 from 11% in 1996. Italy remains in the top bracket in the euro zone in terms of another efficiency indicator, that of labour costs as a percentage of total banking gross income, which is at around 40%, close to France's 37% and Spain's 35%.

Differential between Italy and Europe : Labour costs as a % of gross income

YEAR	DIFF. %	YEAR	DIFF. %
1996	11.0	1999	9.0
1997	12.3	2000	7.5
1998	8.1	2001	7.4

Italian banks have also bridged the gap if we compare total operating costs and gross income: 61.6% in 2001, 4.7 percentage points above the European average, almost halved from the 8.2 point gap registered in 1996.

Italian banking efficiency improved as credit institutions repositioned them-

selves away from traditional activities to increasingly focus their business on services with more added value. The Italian financial system in the 1990s experienced a gradual decline in gross income as a proportion of intermediated funds to 3.7% in 2002 from 4.3% in 1991.

Differential between Italy and Europe : operating costs as a % of gross income

YEAR	DIFF. %	YEAR	DIFF. %
1996	8.22	1999	6.91
1997	10.78	2000	4.97
1998	4.09	2001	4.72

The reduction derives from two opposite trends. Net interest income fell over the period to just above 1.9%, from 3.2% in 1991. Vice versa, net revenue from services, the component of banking revenue generated from non traditional banking services, almost doubled to 1.8% from 1% in 1991.

There is also another factor to take into account when examining the gradual but constant reduction in the net interest income. Italian banks managed to offset the negative effects of this contraction on their margins by increasing revenue generated from other services. The mechanism reflects the ever increasing level of competition in Italy's banking system and highlights the ability of Italian banks to defend and increase profitability both through significant cost cutting and through the expansion of non traditional business.

Indeed, the repositioning of Italian credit institutions to focus on more profitable markets has boosted earnings. Return on equity rose to 13% in 2000, from 1.2% of 1994. The result has been a significant fall in the differential with the European average, to 3.8 percentage points, less than a third of the 11.9% posted in 1997.

The same improvement can be

identified at a profit before tax level. This rose to 0.8% of intermediated funds in 2002 from 0.28% in 1994. The same holds true of net profit, which advanced to 0.49% of intermediated funds, from 0.05% in 1994. Dividend payouts also gained to 0.33% in 2002 from 0.12%.

The increase in profitability after the flurry of mergers and the consolidation of the 1990s also stands out when compared to developments in other European financial services industries. Italian banks' net interest income was decreasing in line with that of other European banks: from the 1979-92 average of 3.3% to 2.3% in 1998. There were similar trends in France, where net interest income dropped to 0.9% of total assets in the period, from 1.8%, in Germany (to 0.9% from 2.2%), in the United Kingdom (to 1.8% (from 3.1%) and in Spain (to 2.8% from 4.1%). The latest figures available on the subject, contained in a report focusing on 25 large European banking groups, indicate that in 2001 and 2002 net interest income stabilized towards the bottom of the range.

The performance of Italian banks also reflects the growth revenue generated by non traditional services.

This business area has been the main engine for profitability growth in Italy. Due notice must be taken of the progress made in this field, particularly half way through the 1990s. In fact, while in 1995 the Italian banking system ranked tenth in terms of size of the services' business in Europe, three years later it had risen to fifth position, lagging only Luxemburg, Sweden, France and Austria.

The second area that merits comparison is that of operating costs. Italian credit institutions experienced a much steeper decline in their expenses than most of their rivals in Europe, particularly in the latter part of the 1990s. This trend permitted Italian banks to start closing the operating costs gap with their European counterparts.

Looking to the future

In the last few years the banking market in Europe and in particular in Italy has evolved dynamically both in terms of the internal organizational

ROE and profits of Italian banks (as a % of total assets)

	1994	1995	1996	1997	1998	1999	2000	2001	2002
ROE	1,2	1,7	3,6	1,8	7,9	10,6	12,9	9,1	6,4
Profit before tax	0,28	0,36	0,50	0,38	0,91	1,01	1,27	0,99	0,80
Net profit	0,05	0,03	0,18	0,04	0,48	0,61	0,79	0,60	0,49
Dividends	0,12	0,14	0,16	0,16	0,25	0,37	0,43	0,39	0,33

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Sous la direction de Nadia ANTONIN

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structure of the individual banks, as well as in terms of the portfolio of products and services on offer to clients.

In particular, the recent evolution of the Italian banking system, in line with the changes in other euro zone countries, has pushed it increasingly and forcibly into the European context. Credit institutions are operating in an environment characterized by the toughening of competition levels and by the expansion of the traditional market boundaries as well as those of the players' strategies.

The economic and institutional scenario not only stimulates a higher degree of competition, but also contributes to the pressure that has been weighing on profit margins for various years a factor which can also be linked to technological and financial innovation. The internationalization of the production systems and the globalization of markets have, on the other hand, led to a rationalization of financial industry's structure in the last two decades, characterized by sudden changes in ownership structure and by a marked tendency towards greater concentrations.

This phenomenon is mainly due to the strategic choices Italian banks have adopted in their bid to grow in size.

Banks' management has taken multiple action in recent years to improve the value creation potential; these projects can be summed up as bids to increase further the levels of efficiency of the organizational structure that works in support of branch networks; to improve the geographical presence to facilitate client access; to improve sales capacity by dedicating increasing resources to improve customer relationships; to boost the capital base (and the regulatory capital as well) and strengthen its internationalization process.

These developments have not reached their conclusive phase, and without doubt in the near future banks will be further influenced both by opportunities and/or threats they will face both domestically and internationally. Banks' ability to take advantage of the opportunities while at the same time balance out the risks will determine the final makeup of our banking system and the conclusive nature of the European banking sector.