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Recent and Future Developments in the Euroland and Greek Financial Sectors

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Abstract

Recent technological advances and changes in the political and macroeconomic climate have inevitably changed the traditional features of the bank sector. Thus it is necessary for banks to adjust their services and products in order to achieve competitiveness in this new banking era. Competition is continuously increasing and banks will have to develop and include in their activities the majority of new financial instruments which have arisen from the newly emerged financial sector. Therefor it is quite clear that in the near future we will see the implementation of new technologies in the banking sector which will lead to differentiated objectives and further consolidation of the sector.

1. Introduction

Never before in the history of European banking have there been so many colossal changes as the ones experienced during the last two decades. The majority of them can be attributed to the change of the political and macroeconomic climate (viz. European Economic Community,, European Union and the Euro). Yet, there are some that can also be attributed to the recent technological advances that enabled the dissemination of knowledge and information at the speed of thought. These changes, in close tie with the better informed clients and consumers, have created a very dynamic and extremely competitive environment that will shape once more the banking landscape in the near future.

In fact, it would be appropriate, due to the wide variety of new financial products, strategies and financial theories, to replace the term banking institution by the term financial institution, for banks will have to include in their array of traditional products and services the majority of the new financial instruments. It is implied, of course, that a great part of the profitability of these institutions originates from «selling» such new financial products vis a vis the traditional depository/lending schemes.

Thus, we can determine two kinds of effects on the banking sector, the static and the dynamic ones. These in turn, can be classified into two categories, the endogenous and the exogenous ones. Static can be the effects of further consolidation and further engancing of the market position. Dynamic can be charac-

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terized as the effects evolving from the penetration of banks into other sectors of the economy such as real estate. Endogenous, on the other hand, are the effects that deal with the changes that come from within (such as management and competition) and exogenous are the effects that are imposed upon banks by political and economic factors. In this paper we are going to deal mostly with the endogenous static and dynamic effects.

Having left behind us the millenium mark, there is growing concern about the future of the traditional banking sector vis a vis the newly emerged financial sector. Indeed, the traditional banking sector has been facing major challenges as regards to the course of its practices. Constantly increasing competition emanation from newly developed practices such as the so called e-banking and m-banking, the violation of traditional banking borders buy stock markets and portfolio management offered by transnational financial institutions that operate like private banks, create the need to forge anew the face of this sector.

The past of international banking has been characterized by several shocks such as the Latin American crisis in the 80's (that almost led giants like Citibank to bankruptcy), or the more recent S&L crisis of the early 90's in the States. Hence, bank managers are rich in experience and can use it in order to minimize their risk. Rethinking of the role of the banking sector in the 00's however, urges us to include some more recent transformations that are still in progress. In particular, the banking system within the Euroland is already more open to intra and extra border competition. Yet, it is more flexible (though more gigantic) than ever before, more risk averse and more profit and size-oriented. Moreover, its management is looking forward to achieve further horizontal integration. This includes a deeper involvement in international stock markets, an expansion of personal banking services and a specialization in venture capital thus providing new, promising businesses (such as e-trade) with comprehensive solutions and the necessary funds. Nevertheless, some of the dangers associated with the financing of the new trends have been clearly understated, like the recent high-tech meltdown shows us.

The key factors that will lay the basis for a solid future growth will heavily depend on the skills of managers to develop new, more efficient strategies, to innovate and to make new products more sellable (they will also have to take into account the intensity of the competition that will emerge). Therefore, it is an imperative that financial institutions will try to gain a comparative advantage amid the emerging banking culture. This will inevitably lead to the further division of the banking sector into two groups: the European International Banks and the European Peripheral Banks (e.g. Deutsche Bank vis a vis Banco Santander Espana). Furthermore, the instant dissemination of information in electronic form will create, on the one hand, the need for the fuller satisfaction of the better informed clients and on the other, the need for stricter and more detailed regulations for the safeguarding of the transactions that occur via the Internet. However, there are some obvious changes that are already developing and can be classified as follows:

2. The Importance of Income and Revenues From Loans Will Gradually be Reduced.

Albeit it would sound absurd, it is not an exaggeration to claim that in the near future banks will not want to lend and clients will not want to borrow. Banks are looking forward all the more to increased returns on their assets and traditional borrowers are not in a position to pay a premium to the regular interest rate. A close look for example at table 1 clearly indicates the increasing importance on profits realized through new activities and particularly financial ones. For instance the Hellenic Banking sector during 1999 derived a solid proportion of its profits by taking advantage of the booming stock market. For example, the profits of Alpha Credit Bank increased by 60%; nevertheless, 111% of the increased profits were produced by activities different than the traditional ones and more specifically by buying and selling stocks and bonds (stocks mostly). Were it not for this source of income, the bank would have reported lower profits for the fiscal 1999. This is not a trend that could continue for a long time. Already, during the year 2000 the Athens Stock Exchange (ASE) has lost its momentum and there are serious reasons to believe that the many shares of the ASE are well into the overvalued territory. Thus, such extraordinary and exceptional items might well be not repeated regularly; for instance many banks have been reporting considerably lower profits for the first three quarters of 2000.

Table 1: *New operations increased the profitability of the Greek banking sector, but it is unlikely that this trend could endure! (all sums in billion GRD)*

Institution	1999 profits (1)	1998 profits (2)	% change (3)	Profits from financial operations 1999 (4)	Profits from financial operations 1998 (5)	(4)-(5)/ (1)-(2) in %
National Bank of Greece	228.7	130.2	75.6%	124.5	56.7	69.8%
Alpha Credit Bank	144.5	90.5	60%	97.5	37.6	111%
Ergobank	92.5	61.5	50.4%	18.4	4.4	46.7%
Commercial Bank*	84.2	30.7	173%	48.2	27.0	39.2%
Bank of Piraeus	50.2	13.6	269%	29.7	7.3	61.2%
Chios Bank	17.7	7.8	127%	3.4	2.2	12%
Macedonia and Thrace Bank	10.4	0	N/A	6.6	3.6	N/A

**the extraordinarly profits from the sale of the Ionian Bank of GRD 211 Bn are not included.*

***Source:** 1999 earning reports*

3. A Gloomy Outlook for Traditional Banking. Businesses Will Realize it is More Expensive to Borrow Money Directly From Banks. Thus, a Brighter Future for Corporate and Private Banking!

With the advent of direct access of businesses to lenders through the offering of corporate bonds, banks will realize it is going to be more expensive to borrow money from their customers in the form of deposits. When fully blown competition takes in, banks will have to offer higher more attractive interest rates to depositors and lower interest rates to borrowers, otherwise businesses will prefer to directly sell their bonds to the public. Moreover, it is more expensive for banks to lend to businesses and hence methods for the reduction of such costs are being implemented. In other words, banks will have to compete with corporations issuing bonds in order to attract their clients' funds, but also, businesses will have to cooperate with banks in order to sell their bonds. The prevailing question, however, is which source of income is more likely to be in the favor of bank managers. Many bankers are already in favor of the second option.

Corporate bonds were considered to be the privilege of big and reliable businesses (often in Europe state-owned)and their debt was rated by serious international institutions (e.g. Moody's). ON the other hand, private banking is a valuable ally for it provides the network to make corporate bonds more sellable. This implies that businesses will avoid borrowing directly from banks if they can manage differently. Consequently, in order for banks to attract depositors' money, competition with an array of high yield corporate and municipal bonds and mutual funs will be fierce. Banks will also have to compete with one another, in order to attract the underwriting of companies that opt to go public in order to improve their finances. This, in turn, creates a highly unstable mixture.

Hence, traditional banking institutions can either choose to compete with new products that attract depositors' money, or they can specialize through their private banking departments in order to offer them. Those who will prefer to compete will realize that net profit margins, as well as their clientele will be shrinking whereas the ones that will try to adapt to the realities of the «new order» will experience higher profits originating from commissions and handling fees. Moreover, the risk of asset-management will be drastically reduced, since customers will be assuming it directly by bearing themselves the responsibility of structuring their portfolios.

4. Banks Will Discover That They Have to Reinvent Their Role, Their Objectives and Their Size!

Last year's decision of Dresdner Bank to end talks of a merger with Deutsche Bank is of utmost importance. Firstly, because it urges the management to invent a new role for the bank. Secondly, because it directly affects the lives of 16,000 employees, an aspect with severe social repercussions which brings politics into the arena of managerial and strategic planning1. Thirdly,

[1] The Economist, March 25th –31st 2000.

because the non-elimination of these jobs will maintain the existing inefficiencies which in the future will forge anew the need for merger-talks.

Traditional managerial practices in banking included the horizontalization of activities by the acquisition of other financial institutions that offered different products, such as the acquisition of Morgan Stanley by Deutsche Bank, and the verticalization of the services provided, such as the internal provision of a full line of services to their clients and the differentiation/diversification of their business by more active involvement in real estate, internet operations and telecommunications. Let it be mentioned, that the recent turmoil in all of the aforementioned sectors (i.e. worsening of real estate prices in the States due to the long overdue recession, telecom upheaval in Europe and high-tech meltdown), might seriously impede the profit growth of several banks.

New managerial practices might well require the transformation of the traditional gigantic banking institution into a flexible electronic financial dwarf! For instance, Greece's Nova Bank, a bank that has started its operation in September 2000, will consist of a network of fifty to sixty small one-stop banking shops, no larger than 30 sq. m. each, where a client will be able to find a multitude of ATM's in order to perform his or her transactions. This means less rents, less employees, an availability of a wider variety of products (from mutual funds to direct stock market trading) at a minimum of a cost. A recent research by Lehman Brothers shows that the cost a bank will incur for a money transfer between accounts mounts up to $1.27 for the traditional teller-client method, $0.30 in the case an ATM is used and $0.01 (!) if a client opts to use the bank's internet facilities!

We can easily assume that a new entrant (such as Nova Bank) will have a significant comparative advantage against the incumbents who will not possess the right amount of flexibility on order to compete. Although in recent years banking officials have been trying to cope with change, banking bureaucracies have been very slow to adapt. This is partly due to the long-lasting and steady growth of international stock markets that had been creating a high proportion of new income thus limiting managerial insight about the new roles they would have to invent for their institutions. Assuming that this was of making a profit (i.e. the exploitation of stock market growth) will be significantly reduced in the future, bank officials will be forced to reduce their operating expenses and payrolls. Banks will have the opportunity to modernize at the expense of wages and payroll accounts, but on the other hand, this definitely implies increased overall efficiency for the economy. It must also be mentioned that European governments are not eager to see layoffs and personnel cuts due to the high political repercussions involved.

5. Deposits Will Face Competition From Other Forms of Investment and Possibly Consumption!

In Western Europe as well as in the States, the marginal propensity to consume has increased significantly over the last two decades. Lower interest rates in conjunction with the consumption boom of the 90's have led to a considerable reduction of the marginal propensity to deposit. This will eventually lead banks to compete (in a manner that could resemble an interest rate «auction») in order

to attract deposits, a move proven to be responsible for increasing the cost of borrowing money and hence the crowding out of private investment.

Since money can be considered as a commodity, in Greece it is expected that bank clients will seek different ways of saving in order to increase the yield of their capital. Yet, the recent stock market turmoil and the stance that most investors have assumed since, is not indicative of a new trend. Also, higher than expected inflation rated leading to negative real interest rates, could drive many people to consume rather than to save. Euro interest rates will be quite low (around 4.75% or lower), particularly in contrast with interest rates Greeks were accustomed to. So, there is a high probability that there will be a forced increase in consumption that could reduce savings and create further inflationary pressures.

6. Competitions From Brokerage Houses Causes Bank Executives Unrest!

In the States brokerage houses offer their clients checking accounts, credit/debit cards and other products in order to increase their participation in those lucrative sectors[2]. Bank officials have been wary of those events and their response was to acquire some of the smaller and more flexible brokerages. This in turn has created increased uncertainty about the future of white collar bank employees. For instance, when CSFB acquired DLJ, the senior chief analyst of the former was sacked (the excuse was for being too bearish).

On the one hand, brokerages are entering into the traditional banking business. For instance, in April E*Trade Group Inc., the second largest on-line brokerage in the States, launched an on-line bank that offers FDIC insured checking and savings accounts and an array of other bank products. Moreover, Charles Schwab the largest discount brokerage in the States, recently announced plans to acquire U.S. Trust Corporation, a bank that caters to wealthy people, for $2.7 billion in stock[3].

On the other hand, the fact that already a large number of brokerages are offering bank-like products such as money-market accounts, ATM access and other, is threatening the incumbents' market shares. The response has been for banks to retaliate by the acquisition of brokerages. Bank of America owns Montgomery Securities, U.S. Bancorp owns Piper Jaffray Cos. and First Union Corp. has acquired Everen Capital Corp.. In Europe trends are predicted to resemble the American ones, yet in Greece brokerage houses are not that strong in order to be able to compete with banks.

7. In Greece, the State's Role Has Been Significantly Reduced.

The Greek State has always been eager to maintain full control of the banking sector by owning and controlling major league banks, like the National, Agricultural and Commercial Banks of Greece, in order to implement its own vision of social policy. During the last three years however, the Greek State has been reducing its stake in most banks. This has led to further developments. The most recent

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[2] CIBC World Markets, April 2000

[3] Chicago Tribune, April 5th 2000

development was the successful IPO of the Agricultural Bank. This has renewed hopes of less State interventionism in the shaping of banking house rules.

The privatization of many smaller state-owned banks that occurred in the years 1998-1999, created two new major banking institutions. The Bank of Piraeus that in 1998 acquired the previously state owned Bank of Macedonia and Thrace, and Alpha Bank that resulted from the merger of Alpha Credit Bank and the privatized Ionian Bank. Hence, the specific weight of the state as a banker was reduced and only partial control of the three aforementioned banks (NBG, ACB, CBG) was maintained.

Conclusions

An expected highly dynamic and open environment will lead bankers (in Greece and in the Euroland) to undertake major strategic risks. Not all of the risks could prove profitable; yet, many might be worth taking in order to deter competition. Traditional banking culture and practices will change, fiercely and violently at a time. Increased competition, narrower profit margins, unfavorable political involvement (quite obvious in the Deutsche-Dresdner deal) and the implementation of new technologies will eventually lead to further consolidation, differentiated objectives and less market participants. Clients will become ever more demanding; it will be difficult to cater to the particular needs of every one, hence the need for further product differentiation and target diversification.

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