# Consolidation, ownership structure and efficiency in the Italian banking system*

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## 1. Introduction

The manifold effects of banking consolidation are the subject of both theoretical and empirical studies. This paper focuses on three key questions: *i*) Is banking concentration increasing or decreasing the Italian financial system's efficiency? *ii*) Is it a stimulus or an impediment to competition in the market for banking and financial services? *iii*) Does it tend to have positive or negative effects for the reallocation of bank ownership?

None of these three questions has received an unequivocal answer in the recent theoretical and empirical literature, and I must clarify from the start that my aim here is not so ambitious as to fit the various responses into a systematic analytical framework. I begin with few general observations allowing me to illustrate some of the effects of consolidation on the Italian banking system in the course of the nineties (Section 2). After describing the basic developments in mergers and acquisitions and the related ownership reallocation in two sub-periods of the nineties, I demonstrate that these processes were accompanied by gains in the efficiency and competitiveness of Italian banking (Section 3). This progress, however, did not offset the increasing inefficiency found in the ownership structure of Italy's largest banking groups and of many medium-sized banks as well (Section

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4). The conclusions (Section 5) summarize the results of the analysis and indicate points for further investigation.

## 2. Some general remarks

In seeking to determine whether mergers and acquisitions enhance the efficiency of banking systems, numerous studies have empirically tested two theoretical hypotheses. The first hypothesis, based on the credible threat of takeover (see, for example, Holmstrom and Tirole 1989), maintains that mergers and acquisitions (M&As) constitute the market's response to the management shortcomings of at least one of the banks involved (the acquired bank), with the aim of maximizing that bank's current value. The second hypothesis focuses on agency relationships between owners and managers (see, for example, Jensen 1986) and holds that M&As, especially in the financial markets, are designed not so much to satisfy efficiency criteria as to serve private interests of management or more general policy choices.

As reviews of the issue show (see, for example, Berger, Demsetz and Strahan 1999), empirical tests so far have not settled the choice between these two theoretical alternatives. Several points made by the current value maximization approach have been validated. For example, many studies recognize that banking consolidation can be an effective tool for reducing excess capacity. And other researches, focusing more specifically on acquisitions, have found that the acquirer banks generally have higher levels of operating efficiency and profitability than the acquired banks. Yet the empirical evidence on the effects of M&As on banks' efficiency is not univocal, at least as far as continental Europe is concerned; the results appear to be influenced above all by the specifics of the cases of consolidation considered (Vander Vennet 1996).

Some of the empirical findings, then, are more consistent with the agency model than with the current value maximization approach. They indicate that the bulk of European bank M&As – namely, those carried out within national markets – are sensitive to opportunistic behavior on the part of management and, especially, to supervisory authorities' and policymakers' objectives of stability. The rationale for takeovers or partial acquisitions of loss-making banks that do not im-

prove the latter's efficiency in the short or medium run lies in that these rescues are intended to safeguard the systemic stability of the national financial markets. Still, the empirical evidence does not permit clear-cut conclusions since it fails to solve questions regarding the specific impact of bank M&As on 'X inefficiency' costs and on the array of financial services offered.

It has often been argued that bank M&As are able to exploit broad scope for improving 'X efficiency' (see, for example, Shaffer 1993; Berger and Hannan 1998). However, recent empirical studies show that such improvements are either very small or else very sensitive to the specific type of transaction (Rhoades 1998, Calomiris and Karceski 1999).

Similar considerations hold for the diversification of financial services offered. Scholars agree that by expanding the range of services produced and distributed by each banking group, M&As should create scope for more efficient risk management at lower costs, thereby opening the way to higher income and profits at unchanged prices (see, for example, Hughes and Mester 1998). But empirical evidence does not indicate that the assets of the new, larger banking groups generally translate into less risky portfolios or increases in income greater than those in the related costs (Berger, Humphrey and Pulley 1996). The former result will occur only if expanding the range of services leads to an appropriate recomposition of banking assets (Akhavein, Berger and Humphrey 1997) or to an adequate geographic diversification, with consequent diversification of the systemic risks (Hughes *et al.* 1999); the latter requires that the possible increases in income be accompanied by economies of scale and scope.

With economies of scale and scope we come to one of the central debates about banking, one touching on the very definition of banks' production function.[1] Until the end of the eighties researchers, especially in the United States, asserted that economies of scale were substantial only for small or medium-sized banks, while economies of scope were difficult to analyze and tended in any case to be weak and to exhibit considerable variance. During the nineties the results of empirical investigations grew less categorical. New and more refined (parametric and non-parametric) tests often found significant economies of scale for medium-sized and large banks (Berger and Mester

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[1] It is sufficient to recall that banks are typically multiproduct companies, and that deposits have been treated as both inputs and outputs of banking.

1997, Dermine 1999).[2] And although the advantages of specialization continue to be emphasized in the literature, the actual evolution of international financial systems suggests that universal banks and both bank and non-bank financial conglomerates can reap substantial economies of scope from the joint production of financial services (Vander Vennet 2000).

These observations are still not sufficient to conclude that the M&As of the past twenty years have produced overall efficiency gains in the banking systems involved.[3] Rather, the rationale for these operations appears to lie in the gradual unification of the European and US banking markets and the consequent moves by individual banks to defend either their own turf or their market shares. The problem is that cross-border bank M&As have so far been negligible in number compared with those between financial intermediaries of the same country (Danthine *et al.* 1999). This tends to raise the degree of concentration of the national financial markets.

Does this mean that bank M&As have reduced the competitiveness of the national financial markets? Adopting the traditional 'structure-conduct-performance' approach (Bain 1956), the answer would have to be yes (see, also, Group of Ten 2001, ch. V). Under that hypothesis, every increase in concentration in a given market, due either to a decrease in the number of firms present or to a higher variance of their shares,[4] facilitates collusive conduct or price leadership that

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[2] It is generally stressed that the larger economies of scale could be the effect of new technologies and of the financial innovations introduced in the banking sector. It should be recalled that substantial size is required for banks to be able to use derivative products or sophisticated risk management techniques. Note also that more and more financial services no longer have the form of personal debt contracts and have been transformed into negotiable assets. It is not advantageous for small banks to produce these services, but they can acquire and distribute them.

[3] The foregoing observations refer specifically to banks' operating efficiency and do not address important problems of allocative efficiency. Bank mergers could generate distortions in the supply and changes in the composition of financial services that penalize small and medium-sized firms. Recent empirical studies based on US data (Berger *et al.* 1998, Peek and Rosengren 1998, Strahan and Weston 1998) show that this actually did occur in mergers between large banking groups but not in mergers between smaller banks. The systemic effects were modest, however, thanks to the compensating reaction of local banks. Empirical findings for Italy indicate that small and medium-sized firms may be penalized more heavily (Sapienza 1997).

[4] There is no single measures of concentration. For now I shall refer to the traditional Herfindahl index (HHI), which is equal to the sum of the squares of the market shares of each firm and thus increases as the number of competitors decreases and as the variance of their market shares increases. Because of the Herfindahl index's theo-

moves away from competitive equilibria and, hence, from Pareto-efficient situations.

The problem is that the empirical evidence on the link between concentration and market power is not unequivocal. The US data for the eighties show that the more local markets are concentrated, the more banks raise lending rates and lower deposit rates, especially for small customers (see, for example, Berger and Hannan 1989; Hannan and Berger 1991). Moreover, in Europe as well, there are significant positive relationships between market concentration and interest rate spreads (Dermine 1999). However, the US data for the nineties present a more mixed picture. They show that the relation between market structure and market power is not linear but tends to vanish beyond a certain degree of concentration (Jackson 1997). The same data also demonstrate that the number of banks and the variance of their market shares are not accurately defined by the traditional indicators of concentration (Rhoades 1995). The result is the evaporation of any correlation between these indicators and the behavior of bank deposit rates (Hannan 1997), except in extreme cases (Prager and Hannan 1999), and even a slight narrowing of the spread between lending and deposit rates following bank mergers (Akhavein, Berger and Humphrey 1997). What is more, consolidation has had negligible effects on US banks' recent earnings (Chamberlain 1998).[5]

Berger, Demsetz and Strahan (1999), seeking compatibility between the above-mentioned empirical results and weak versions of the structure-conduct-performance hypothesis, submit that, while a correlation cannot be found between concentration and market power for the wholesale financial services that international banks offer to large borrowers, such a link persists for the traditional services supplied to small borrowers in local markets. Berger, Demsetz and Strahan also remark that a failure to distinguish between large and small borrowers

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retical and empirical shortcomings, it cannot be used for reliable international comparisons. In Section 3 I shall therefore use a less sophisticated index of concentration: the share of assets of the five largest banking groups in each national market.

[5] In US this also holds in part for the eighties. Gilbert (1984) finds a positive correlation between concentration and profitability in only a little more than half of the cases examined. These results are not decisive, however. They could indicate that M&As do not increase the monopoly positions of the new banking groups, or that the latter's greater monopoly rents do not translate into profits because they are appropriated by the managers or by other coalitions of employees owing to agency problems or 'influence costs' (see, for example, Milgrom and Roberts 1992).

may vitiate the empirical findings for the US in the nineties that we have just examined.[6] On the other hand, the same authors suggest that bank M&As have further eroded the accuracy of the traditional measures of concentration (the Herfindahl index in particular): by attenuating market segmentations and making many financial services negotiable, consolidation processes have redefined the reference markets (Santomero 1999).

These points strengthen the criticisms of the structure-conduct-performance approach and call the validity of the related index of concentration into question. Cetorelli (1999) offers an important contribution to filling the resulting theoretical and empirical void. Using also numerical examples, he completes the critique of the structure-conduct-performance hypothesis and of the Herfindahl index by showing that the relation between concentration and market power holds only if banks behave in a non-strategic manner; otherwise, the reference to market structure may be misleading for the purpose of establishing whether a banking consolidation has positive or negative effects on competition.

This first conclusion appears to validate the contestable market theory as the new reference model. The theory argues that the strategic behavior of agents is crucial, since the efficiency of a given market depends on the dynamic barriers to entry and the intensity of sunk costs but not on the degree of concentration (Baumol, Panzar and Willig 1982). The problem is that this theory is not readily compatible with the notion of information asymmetries, which now constitutes the foundation of any analysis of the financial markets (Stiglitz 1987). This confirms the lack of a robust and consistent theoretical framework for investigating the links between bank M&As and banking market competitiveness. Without denying that market structure can influence banks' behavior, Cetorelli (1999) reaches a drastic conclusion, namely that the best course is to proceed directly with empirical analysis. Modeling strategic behavior of oligopolistic banks that approximates their competitive behavior, he shows that, by and large,

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[6] This position is borne out in part by empirical evidence on local credit markets in Italy. Sapienza (1997) shows that M&As involving banks with substantial initial shares in local markets do result in higher bank lending rates. On the other hand, Angelini and Cetorelli (2000), who also examine local banking markets in Italy, do not find significant links between M&As and gains in market power for the banks involved.

bank M&As do not increase banks' profits, especially if the markets remain somewhat contestable.

Even if banking consolidation is not detrimental to market competitiveness, this does not mean that excessive concentration in the number of suppliers does not cause problems. Particularly in national markets of modest size, a handful of large banking groups can become 'too big to fail' by transforming their own specific risks into systemic ones (Group of Ten 2001, chapter II; Dermine 1999). To limit the negative implications of this, it is essential that the new banking combinations have efficient forms of corporate governance, able to encourage the maximization of expected value and minimize the effects of adverse selection and 'moral hazard'. To this end it is necessary, although not sufficient, that competition win out in a specific but crucial market: the market for property rights.

One of the most convincing analyses of ownership structure establishes the efficient allocation of residual rights of control endogenously.[7] The criterion to be satisfied is simple: ownership, which legitimates the exercise of the residual rights, is attributed to the person in a position to make the key choices for the business and who must therefore enjoy advantages in solving the problems caused *ex post* by incomplete contracts and market failures. Such a person is designated an 'indispensable agent'. It follows that an ownership structure must be contestable in order to satisfy the minimum efficiency requirement, i.e. it must be subject to modification by the market whenever there are changes involving the selection of the 'indispensable agent' and whenever the latter proves unable to cope with operating and strategic problems as they arise.

Without delving into the merits and limits of the theory of property rights, it is sufficient to note that bank M&As, by redefining corporate governance and the organization of business, tend to generate changes of a scale sufficient to modify both the ownership structure of the resulting institution and the efficient allocation of its ownership rights. It would thus be necessary to ask whether the new allocation is contestable and whether it is attributed to 'indispensable agents'. As far as I know, there have been no systematic empirical studies of these possible effects of bank M&As.

[7] See Grossman and Hart (1986), Hart and Moore (1990) and Hart (1995).

## 3. The two phases of the nineties

We have seen the difficulty of determining whether M&As generally increase the efficiency of the banking system and affect the competitiveness of banking markets. The strongest evidence indicates that the possible efficiency gains depend not so much on consolidation per se as on the specific forms consolidation takes. It also suggests that the rationale for bank M&As lies in the unification of European and international financial markets. Finally, it shows that the traditional indices of concentration do not adequately capture market structure, and that increases in competition following bank M&As are therefore possible. These results, together with the outcomes of M&As for the allocation of ownership rights in the banking system, need to be validated in the light of specific processes of consolidation. Accordingly, this section and the following one concentrate on an empirical description of the Italian case.

Between 1990 and 2000 the Italian banking system experienced one of the fastest processes of consolidation in continental Europe (Table 1). In 1993, moreover, Italy launched a radical privatization of state shareholdings of banks. By early 2001, when the privatization process was basically complete, the percentage of the Italian banking system owned by the central government and other public entities had been reduced to a negligible level (0.12 in terms of total assets); in fact, nearly all the remaining small stakes in banks belong to the category of state assets that can be sold by means of simplified procedures, including mechanisms that are part of standard financial market practices for disposing of equity securities (Ministero del Tesoro 2001).

The interconnected processes of consolidation and privatization deserve closer scrutiny. Table 1 shows that Italy was second only to Germany in the number of bank M&As carried out in the nineties but led Europe in M&As relative to the numerical size of the national banking system. Table 2 allows the phenomenon to be specified further.[8] Counting 'acquisitions of the majority of the capital' along with mergers and full acquisitions, between 1990 and 2000 there were 514

[8] The discrepancy between the data of Tables 1 and 2 is attributable to the different classifying criteria adopted by the Bank of Italy, which are specified in the legend to Table 2.

operations in Italy, a number equal to almost 45% of the number of banks existing in 1990 and more than 61% of that in 2000. Measured by the volume of assets at the beginning of the period, the M&As carried out between 1990 and 2000 involved more than 46% of the Italian banking system.

TABLE 1

TOTAL NUMBER OF M&AS OF CREDIT INSTITUTIONS

| | 91-92 | 93-94 | 1995 | 1996 | 1997 | 1998 | 1999 | First semester 2000 |
|---|---|---|---|---|---|---|---|---|
| Austria | 35 | 19 | 14 | 24 | 29 | 37 | 24 | 8 |
| Belgium | 22 | 18 | 6 | 9 | 9 | 7 | 11 | 3 |
| Germany | 71 | 83 | 122 | 134 | 118 | 202 | 269 | 101 |
| Denmark | | | 2 | 2 | 2 | 1 | 2 | 2 |
| Spain | 76 | 44 | 13 | 11 | 19 | 15 | 17 | 29 |
| Finland | | | 9 | 6 | 5 | 7 | 2 | 5 |
| France | 133 | 71 | 61 | 61 | 47 | 53 | 55 | 25 |
| Greece | | | 0 | 1 | 3 | 9 | 8 | 1 |
| Ireland | | | 3 | 4 | 3 | 3 | 2 | 0 |
| Italy | 122 | 105 | 73 | 59 | 45 | 55 | 66 | 30 |
| Luxemburg | | | 3 | 2 | 3 | 12 | 10 | 8 |
| The Netherlands | 20 | 13 | 7 | 11 | 8 | 3 | 3 | 5 |
| Portugal | | | 6 | 6 | 2 | 5 | 2 | 9 |
| Sweden | | | 1 | 2 | 5 | 1 | 7 | 2 |
| United Kingdom | 71 | 40 | 6 | 11 | 21 | 24 | 19 | 6 |
| Total | | | 326 | 343 | 319 | 434 | 497 | 234 |

*Source*: ECB (1999 e 2000b).

Although the decline in the number of banks was slower than in Spain, France and Germany, Italy saw an appreciable reinforcement of banking groups and an associated drop in the number of independent banks (Banca d'Italia 2001, ABI 2001). Considering the roughly 500 mutual banks (*banche di credito cooperativo*) as members of a single ideal group, at the end of 2000 there were some 75 banking groups and just over 100 unaffiliated banks. The 74 banking groups proper comprised a total of 217 banks with an aggregate share of just under 90% of the national market (94% counting the mutual bank 'group').

These figures are corroborated by the changes in the degree of concentration of the national market, roughly gauged here by the five

largest groups' share of total banking assets (see note 4). As Table 3 shows, in 1990 the degree of concentration of the Italian banking market was around 29%, nearly 22 percentage points below the average for the countries of the European Union and lower than the figures for all of continental Europe except Germany (and Luxembourg). At the end of 1999 it verged on 50%, appreciably closer to the EU average of around 57%. In 2000 the market share of Italy's five largest banking groups rose by a further 4 percentage points to stand at 54% at the end of the year; that of the country's ten largest groups amounted to 67% (see Figure 1). If *de facto* banking groups are included,[9] the gap between Italy and the European Union has been closed.

TABLE 2

MERGERS, ACQUISITIONS AND CONTROL IN THE ITALIAN BANKING SYSTEM [1]

| Year | Number of banks | | Mergers and full acquisitions | | | | Majority acquisitions | |
|---|---|---|---|---|---|---|---|---|
| | | of which: BCC | Number of operations | of which: BCC | Total assets [2] | of which: BCC | Number of operations | Total assets [2] |
| 1990 | 1,156 | 715 | 19 | 10 | 1.06 | 0.02 | 4 | 0.37 |
| 1991 | 1,108 | 708 | 33 | 22 | 0.45 | 0.03 | 5 | 0.37 |
| 1992 | 1,073 | 700 | 20 | 9 | 3.04 | 0.01 | 1 | 0.01 |
| 1993 | 1,037 | 671 | 38 | 25 | 0.63 | 0.05 | 6 | 1.50 |
| 1994 | 994 | 643 | 42 | 25 | 1.59 | 0.05 | 10 | 1.90 |
| 1995 | 970 | 619 | 47 | 28 | 1.57 | 0.10 | 19 | 4.50 |
| 1996 | 937 | 591 | 37 | 25 | 0.47 | 0.05 | 19 | 1.08 |
| 1997 | 935 | 583 | 24 | 12 | 0.80 | 0.05 | 18 | 3.42 |
| 1998 | 921 | 562 | 27 | 18 | 2.65 | 0.08 | 23 | 11.02 |
| 1999 | 876 | 531 | 36 | 23 | 0.39 | 0.06 | 28 | 14.35 |
| 2000 | 841 | 499 | 33 | 22 | 1.50 | 0.09 | 25 | 4.94 |
| **Total** [3] | – | – | **356** | **219** | **13.65** | **0.46** | **158** | **32.63** |

[1] If the full acquisition is subsequent to the acquisition of control, it is not registered, unless it has taken place during the same year, in which case the acquisition is not taken into account. Operations with foreign bank branches are excluded as are infragroup operations and operations involving special credit sections. The date of registration within the group is taken into account for majority acquisitions while for mergers and full acquisitions the valid date is that in which the act becomes effective. The volume of assets considered is that at December of the year previous to the operation. As regards mergers, the volume of assets of the smaller bank is taken into account. Mergers between several banks are considered as one operation; the volume of assets of the largest bank is excluded. The transfer of assets and liabilities are considered as full acquisitions.
[2] As a percentage of the entire system.
[3] The sum total is determined on the ratio between the total assets of banks involved in M&A activities during the period 1990-2000, and the total assets of the Italian banking system.
*Source*: Banca d'Italia (2001).

[9] Some medium-sized banks, though formally independent, are actually components of major banking groups. The acquisition of substantial minority stakes in these institutions has created solid, asymmetrical relationships of alliance.

Table 3

FIGURE 1

CONCENTRATION AND PRIVATISATION IN THE ITALIAN BANKING SYSTEM
(share of assets at December of each year, in percentage)

Figure 1

Source: Banca d'Italia (2000 and 2001), my estimates.

During the past decade bank M&As in Italy often went hand in hand with changes in ownership structure, whose impact was at least equally important. These changes were due primarily to privatizations.

Up to the early nineties, the Italian government directly or indirectly (via IRI) held the absolute majority of the capital of two 'banks of national interest' (Banca Commerciale Italiana and Credito Italiano), as well as of two other important banks (Banca Nazionale del Lavoro and IMI). It also had an indirect but significant stake in the Italian main investment bank (that is, Mediobanca) and in the third Italian bank of national interest (Banca di Roma), and minority equity interests in one of the three remaining major banks. The government appointed the board of directors of the large majority of savings banks, public-law banks and pledge banks. Hence, in 1994, the Italian government still owned a large majority of the national banking system (62% of the total assets). Moreover, into the second half of the nineties the state was also the majority shareholder of southern Italy's two largest banks, Banco di Napoli and Banco di Sicilia. Between the end of 1993 and February 2001, it disposed of its majority interests in seven of the leading banking groups, its indirect minority holdings in two other major groups and its majority or minority stakes in four minor financial institutions. The proceeds from these disposals amounted to nearly 13 billion euros, equal to about 13% of total privatization receipts.[10]

Unlike the conflicting evidence gleaned from the international literature, the time series of fundamental financial statement ratios show that consolidation and the reallocation of ownership of Italian banks were *accompanied* by increases in both operating efficiency and market competitiveness (Banca d'Italia 1994, 1997, 2000, 2001; ABI 1999, 2000, 2001).

For the changes in operating efficiency, it is sufficient to refer to two series: 1) dividends and income from services in relation to net interest income; and 2) operating costs, staff costs in particular, in relation to total assets or operating income. For the variations in the de-

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[10] See Table 4, which is based on data from Ministero del Tesoro (2001), and Inzerillo and Messori (2000). For further information, see also Gros Pietro, Reviglio and Torrisi (2001).

Table 4

Table 4 (cont.)

Table 5

Table 5 (cont.)

gree of competitiveness, we consider net interest income per se and in relation to total assets.[11]

Table 5 shows that the ratio of Italian banks' operating income to total assets decreased moderately over the period as a whole, from 4.3% in 1991 to 3.7% in 2000. The decline was not linear, in part because it reflected the contrasting dynamics of the two components of net income:[12] net interest income, i.e. the proxy of banks' income from traditional activity, fell from more than 3.2% of total assets in 1991 to just above 1.9% in 2000, while net income from services, i.e. the proxy of banks' income from non-traditional activities, rose from 1% of total assets in 1991 to 1.8% in 2000. As a result, operating income declined as a percentage of total assets up to 1997, recovering thereafter thanks to the growing importance of non-interest income. According to Italian Banking Association (ABI) data, net interest income still accounted for 75% of operating income in 1994 and 70% in 1995; its share fell below 50% in 1999 for the sample of banks and in 2000 for the sample of banking groups.[13]

The limited data examined also show that Italian bank M&As were *accompanied* by repeated gains in competitiveness of the markets in traditional activities. Between 1993 and 2000 net interest income tended to decline, a pattern we can attribute to the fall in interest rates in light of the fact that it was broken only in 1995 and 2000, when relatively tighter monetary conditions prevailed in Italy. Moreover in 2000, as in the three years between 1991 and 1993, net interest income contracted slightly in relation to total assets (Table 5). The growth of 7.6% in its amount in 2000 reflected that in the volume of lending rather than any rise in average margins (Banca d'Italia 2001, p. 243;

[11] In the next section some reservations will be raised about the accuracy of such a measure of competitiveness for the more recent years.

[12] There is only an approximate correspondence between operating income and 'net income' owing to accounting and organizational factors. Here it is sufficient to note that during the nineties Italian banks increasingly spun off some of their most profitable services (e.g. various forms of asset management), income from which thus ceased to appear in their financial statements. It follows that the change in the ratio of Italian banks' actual 'net income' between 1991 and 2000 could have been positive despite the decrease in the ratio of operating income.

[13] See Figures 2a and 2b. The ABI sample today covers more than 92% of the total assets of the Italian banking system. Because it was modified between 1990 and 1993 and again in 1996, I have chosen to refer exclusively to the new sample (ABI 2001). Note, however, that on the basis of the universe considered by the Bank of Italy, in 2000 net interest income still accounted for a larger share (53%) of operating income than income from services (see Table 5).

FIGURE 2A

COMPOSITION OF OPERATING INCOME (BANKS)

Figure 2a

Source: Abi (2001); sample of 100 banks.

FIGURE 2B

COMPOSITION OF OPERATING INCOME (BANKING GROUPS)

Figure 2b

Source: Abi (2001); sample of 28 banking groups.

ABI 2001, pp. 37-47). This implies that there was no appreciable change in the spread between lending and deposit rates in that year.

Finally, Table 5 shows that between 1991 and 2000 the other indicator of bank efficiency followed an improving trend: both total operating costs and staff costs fell substantially in relation to total assets. If in 1991 operating costs amounted to just under 2.75% and staff costs to over 1.80% of total assets, by 2000 the corresponding ratios had fallen to just over 2% and 1.15% respectively.[14] In the nineties the relative compression of costs and the growth in income from services were indeed large enough to offset the effects of the increase in competition on Italian banks' profitability. Table 5 shows that the ratio of profit before tax to total assets (1.3%) and the return on equity (18.4%) of Italian banks in 2000 were high even compared with the levels of profitability of the turn of the nineties, when Italian markets were highly segmented and accordingly largely immune from competition.

This positive picture is confirmed by an international comparison. As reported in Tables 6, 7 and 8, during the nineties Italian banks recorded: *i*) a decline in net interest income as a percentage of total assets not unlike that registered in the main countries of the European Union; *ii*) increases in the ratio of income from services to total assets that were higher than the average for the other main European countries; *iii*) a ratio of operating costs to operating income that, after rising until the second half of the decade, fell more sharply than that of banks in the other countries of continental Europe; *iv*) a stringent curbing of staff costs, whose ratio to operating income came down from its earlier peaks to stand at the lower end of the scale in continental Europe (36% in 1999 and 31.5% in 2000; see Banca d'Italia 2001, p. 285). Although Italian banks did not regain the leading positions they had customarily held during the eighties in terms of profitability, by the end of the nineties their ratio of gross profits to total assets (and to operating income) was higher than the European average and their return on equity had approached the average.

The evidence reviewed so far shows that consolidation and changes in ownership of Italian banks in the nineties were *accompanied* by efficiency gains and by a step-up in competition which did

[14] Operating costs rose by 4.7% in 2000 owing primarily to major technological and organizational adjustments (Banca d'Italia 2001, p. 285). The figure for staff costs in 1998 benefited from tax reliefs.

TABLE 6

INTERNATIONAL COMPARISONS
ON A SELECTION OF ECONOMIC INDICATORS

**Interest income (% of total assets)**

| | 1979-92 | 1993-95 | 1996 | 1997 | 1998 |
|---|---|---|---|---|---|
| France | 1.75 | 1.26 | 1.20 | 1.03 | 0.94 |
| Germany | 2.23 | 2.11 | 1.71 | 1.60 | 1.47 |
| Italy | 3.30 | 2.71 | 2.44 | 2.17 | 2.06 |
| United Kingdom [a] | 3.05 | 2.37 | 2.17 | 2.09 | 2.13 |
| Spain | 4.10 | 3.02 | 2.42 | 2.28 | 2.09 |
| EU [b] | 2.84 | 2.27 | 1.87 | 1.72 | 1.63 |

**Operating income (% of total assets)**

| | 1979-92 | 1993-95 | 1996 | 1997 | 1998 |
|---|---|---|---|---|---|
| France | 2.31 | 2.15 | 1.92 | 1.86 | 1.96 |
| Germany | 2.81 | 2.68 | 2.29 | 2.24 | 2.18 |
| Italy | 4.32 | 3.68 | 3.76 | 3.55 | 3.81 |
| United Kingdom [a] | 4.90 | 4.20 | 3.57 | 3.41 | 3.52 |
| Spain | 4.90 | 3.95 | 3.49 | 3.42 | 3.26 |
| EU [b] | 3.59 | 3.11 | 2.85 | 2.72 | 2.79 |

**Operating costs (% of operating income)**

| | 1979-92 | 1993-95 | 1996 | 1997 | 1998 |
|---|---|---|---|---|---|
| France | 71 | 67 | 70 | 69 | 68 |
| Germany | 64 | 62 | 58 | 58 | 60 |
| Italy | 63 | 66 | 69 | 73 | 65 |
| United Kingdom [a] | 66 | 64 | 62 | 61 | 57 |
| Spain | 65 | 61 | 64 | 64 | 64 |
| EU [b] | 65 | 64 | 64 | 64 | 63 |

**ROA**

| | 1979-92 | 1993-95 | 1996 | 1997 | 1998 |
|---|---|---|---|---|---|
| France | 0.28 | 0.01 | 0.18 | 0.29 | 0.39 |
| Germany | 0.24 | 0.27 | 0.48 | 0.45 | 0.66 |
| Italy | 0.43 | 0.11 | 0.56 | 0.40 | 0.94 |
| United Kingdom [a] | 0.40 | 0.67 | 1.04 | 1.15 | 1.15 |
| Spain | 0.76 | 0.45 | 0.88 | 0.94 | 0.94 |
| EU [b] | 0.43 | 0.21 | 0.62 | 0.62 | 0.78 |

**ROE**

| | 1979-92 | 1993-95 | 1996 | 1997 | 1998 |
|---|---|---|---|---|---|
| France | 7.91 | 0.15 | 4.3 | 7.4 | 9.6 |
| Germany | 6.63 | 6.38 | 13.3 | 12.8 | 19.3 |
| Italy | 10.61 | 1.58 | 8.3 | 5.9 | 13.3 |
| United Kingdom [a] | 8.11 | 17.11 | 26.5 | 25.6 | 25.8 |
| Spain | 9.01 | 5.03 | 16.1 | 17.1 | 17.4 |
| EU [b] | 8.54 | 3.29 | 14.2 | 13.9 | 17.4 |

[a] The data refer to commercial banks.
[b] For the years 1979-92 and 1993-95, the EU average is based on the four Continental European countries examined above.

*Sources*: Banca d'Italia (1997) and ECB (2000a).

Table 7

Table 8

not erode banks' profitability too heavily. This does not mean that it would be legitimate to attribute strict cause-and-effect relations to these developments. On the basis of international empirical findings (see Section 2), it can be plausibly argued that larger size enabled Italian banks as well to expand their income especially from non-traditional services, and that the new information technologies allowed them to move toward a more efficient organization of work and channels of distribution. On the other hand, considerable evidence suggests that Italian banks have yet to rationalize various non-staff costs. One especially worrisome fact is that the number of bank branches rose heavily in the nineties in Italy, contrary to a flat trend in the large majority of the other advanced countries. This tendency has continued into the most recent years, when banks have become increasingly committed to online distribution.[15]

It should also be noted that the legislative and regulatory changes and new forms of supervision introduced at the end of the eighties and at the beginning of the nineties were decisive in lowering barriers, reducing market segmentations and integrating the Italian financial system into Europe. This had beneficial effects for competition and hence for the Italian banking system (Ciocca 2000). Moreover, as the careful empirical study by Focarelli, Panetta and Salleo (1999) has shown, consolidation in Italian banking between the mid-eighties and 1997 did not significantly enhance either system-wide efficiency or the range of services offered. Although many of the M&As of that period aimed at creating banks with a strong geographical base (especially on the funding side), their most positive outcome was an improvement in the efficiency of acquired banks (particularly on the cost side) rather than in the income or costs of acquiring banks.

If the above considerations did not suffice, there would be a further, decisive argument against drawing simple causal connections between M&As and the market structure (or performance) of the Italian banking system throughout the nineties: the fact that the dynamics of the above indicators of efficiency and, especially, profitability were not uniform but actually followed two contrasting trends between

[15] Although many of the new branches are lightly staffed (the average number of employees per branch has fallen appreciably), new branch openings increased by nearly 4% in 2000. While this phenomenon is plainly a reaction to the restrictive policies of the past, the growth in the branch network is also aimed at protecting Italian banks' traditional factors of comparative advantage.

1993 and 2000. Tables 5 to 8 tell us that the period from 1993 to 1997 was a difficult time for Italian banks, whose financial statements ranked low in Europe for efficiency and profitability; the recovery culminating in the excellent results of 2000 did not begin until 1998. A plausible explanation is that between 1993 and 1997 the legislative and regulatory changes and the increase in market competition were not accompanied by adequate cost control and income diversification. On the basis of this reading, if consolidation and ownership reallocation had positive effects on efficiency and competition, they came with a considerable lag. Table 9 confirms this lag: in 1997 the financial statement indicators of the ten largest Italian banking groups and the other Italian banks involved in M&As were worse than those of the rest of the system, whereas by 1999 both of these groupings had pulled ahead in cost efficiency and profitability.

The picture presented does not suggest causal connections between competition, efficiency gains, profitability and the consolidation and reallocation of ownership of the Italian banking industry. Rather, it reveals complex interaction between these four phenomena in the wake of the legislative and regulatory developments of the early nineties. This is borne out by the fact bank consolidation in the nineties can be divided into two phases coinciding with the opposing trends in profitability and efficiency. Up to May of the last year of poor performance (1997), consolidation did not involve transactions between the largest players but was aimed at rescuing distressed banks (especially in the South), rationalizing specific situations and strengthening the geographical base of operations of both large and small/ medium-sized institutions. In the second phase, beginning in mid-1997 and continuing through three years of increasing profitability, the crucial feature was consolidation between the largest Italian banking groups, operations designed to create a handful of players able to compete in both traditional banking activities in the wealthiest local market and in non-traditional services nationwide.[16]

TABLE 9

[16] There is an interesting analogy with the two phases of bank M&As in the United States some years earlier. Mishkin (1999) reports that the balance-sheet difficulties of the US banking industry between 1980 and 1992 went hand in hand with an initial phase of rapid consolidation. From 1993 on the return of banks to high profitability was accompanied by a second wave of M&As aimed at curbing costs, expanding the range of services offered and making distribution more efficient.

CONSOLIDATION AND ECONOMIC INDICATORS [a]
(in percentages)

| Items | Credit institutions involved in consolidation processes [b] | | | | Credit institutions not involved in consolidation processes | |
|---|---|---|---|---|---|---|
| | Large credit institutions [c] | | Other credit institutions | | | |
| | 1997 | 1999 | 1997 | 1999 | 1997 | 1999 |
| | Economic indicators | | | | | |
| Net interest income/operating income | 64.8 | 56.8 | 69.4 | 58.4 | 71.4 | 62.2 |
| Non-interest income/operating income | 13.5 | 22.9 | 11.9 | 22.3 | 9.4 | 18.6 |
| Operating costs/non-interest income | 71.9 | 63.8 | 66.7 | 64.0 | 66.1 | 64.2 |
| Staff costs/operating income | 47.1 | 40.3 | 39.9 | 36.1 | 38.4 | 34.8 |
| ROE | –4.5 | 12.3 | 5.4 | 10.2 | 5.8 | 4.4 |
| Number of employees [d] | –11.8 | | 1.2 | | 9.0 | |
| Premature resignations [e] | 11224 | | 6297 | | 1553 | |

[a] Estimates based on individual reports. The series are reconstructed on the basis of M&As that took place during the period.
[b] The credit institutions concerned are those which from 1993 onwards were involved in at least one merger, full acquisition or majority acquisition.
[c] The first 10 credit institutions.
[d] Changes in the period 1997-99.
[e] Number of employees who prematurely resigned from their job in the period 1997-99.

*Source*: Banca d'Italia (2000).

## 4. Income from services and ownership structures

Consolidation and ownership reallocation in the years from 1990 to 2000 were closely interwoven and led to the formation of five banking groups whose weight in the domestic market is comparable to that of their counterparts in other European countries. We have seen that the two processes were accompanied by a recovery in bank efficiency and by increases in the competitiveness of the markets. This did not negatively affect the profitability of Italy's large banks. On the contrary,

from 1998 onward a long standing pattern was reversed as the second phase of consolidation unfolded, with major and large banks now reporting a higher return on equity than the others (Banca d'Italia 2001, p. 321).

Such a positive picture appears to be out of line with the checkered empirical findings on M&As in other banking systems (see Section 2). In reality, the apparent benefits of banking consolidation in Italy derive primarily from the fact that the unification of the European and international financial markets is imposing standards of organization and size incompatible with Italy's pre-existing financial structure. Whether or not there are causal connections between consolidation and efficiency gains in an abstract banking system, in the Italian case M&As have in fact served to narrow the actual gap between Italy and the other countries of the European Union. The question is whether that gap has been closed. At least four problems suggest a negative answer: *a*) the M&As carried out by the largest Italian banking groups are not sufficient to ensure the organization and minimum efficient size necessary in order to compete in the European and international markets; *b*) despite the greater weight of non-traditional services, Italian banks' factors of competitiveness are still keyed to strong local roots and retail business; *c*) in view of the importance of local retail business, the increase in non-interest income may stem at least in part from insufficient price competition; *d*) the combination between M&As and ownership reallocation has not produced efficient forms of ownership.

A simple fact is an appropriate starting-point for addressing the first of these problems: between 1969 and 1972 Italy, alongside the United States and the United Kingdom, was the only country with a bank among the world's ten largest in terms of assets in each and every year.[17] At the end of 2000, Italy's three largest banking groups do not even figure among the top thirty in the world and the top fifteen in Europe still in terms of assets. This is cause for concern, considering that the leading experts today predict that the unification of the European and international financial markets will reduce the number of EU banking groups to a handful of global players flanked

[17] Group of Ten (2001, p. 453). In 1970 Italy was joined by Canada and in 1971 by Japan, France and Germany. More recently, Switzerland and the Netherlands have appeared on the list.

by a dozen or so able to compete at the continental level (European 'super-regional' banks). The remaining European banks will have to face outside competition within their own national arenas, playing the role of European 'regional' banks (ABI 1998). The risk is that all Italian banks, large as well as small, will be reduced to the 'regional' sphere.

This risk depends not so much on Italian banks being smaller than their European competitors but on their supplying an inadequate or geographically concentrated range of services. In order to operate as a super-regional, it is not enough for a bank to attain a minimum efficient size; it also has to participate actively in international alliances, be competitive in retail and corporate banking as well as in corporate finance or else become a European leader in its own field of specialization. European banking groups that aspire to play super-regional roles have recently moved in these directions, acquiring equity interests (often minority stakes) in foreign banks and implementing clear organizational choices. Some of them have concentrated on retail business but have directly or indirectly gained positions of leadership in crucial markets; others have specialized in high-margin financial services;[18] still others have joined up with non-bank intermediaries (a typical case is that of bank-assurance); and several banking groups have adopted a model closer to that of the universal bank, building a good ability to compete in a wide range of retail and corporate services. By contrast, the major Italian banking groups have limited themselves to exploiting the advantages of their geographical base in order to defend their positions in the national retail markets (including asset management), showing structural weaknesses in both corporate banking and, above all, corporate finance.

By realistic reckoning, Italy will be able to create no more than three super-regional banking groups. It is therefore useful to specify the previous problems, stressing several limits that are common to the main M&As of the second phase, that is the consolidation between the largest Italian banking groups.

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[18] I am not concerned here with evaluating the short-term efficacy of these different strategies. It is well known, for example, that the current troubles of investment banking weigh on the balance sheets and organizational choices of important intermediaries. This does not alter the fact that investment banking is an essential component of supply in the financial markets and can be an excellent specialization for a 'super-regional' bank or even for a global player.

Consolidation in Italy has most often adopted federal models, with the various banks involved brought under a single holding company and part of the back-office activities transferred to a central apparatus. These federal models have left the participant banks with wide margins of autonomy and have extended the territorial base of the new banking groups. This has made it possible to overcome local resistance to consolidation and to strengthen traditional components of retail business, but in the future it could create binding constraints to the efficiency gains and the diversification of services. Evidence of the problem are the attempts to move beyond the initial federal model barely three years after it was put in place, at the price either of major strategic fluctuations (from multifunction group to integrated bank), or of local resistance. On the other hand, the few M&As directed from the very outset at creating integrated, multi-specialist banking groups have also encountered organizational difficulties. This approach has yet to translate into adequate exploitation of the range of services available and has created comparative disadvantages in terms of geographical base that cannot be sidestepped through acquisitions of minority stakes or compromise solutions.

These limits are strengthened by the subordinate role that Italy's larger banking groups are playing in the international arena. Apart from relationships inherited from the past and recent initiatives *vis-à-vis* the countries of Eastern Europe,[19] in the EU market Italy's major banks have taken their cue from their principal foreign shareholders.[20]

Perhaps the most negative result of Italian banks' weakness in specialization and alliance-making is their increasingly marginal role in corporate finance and investment banking in the European market and even in Italy. The unrepeatable opportunities that were offered in Italy during the nineties by privatization and ownership reallocation in the financial and non-financial sectors were grasped by the major international investment banks rather than by domestic operators.

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[19] Three major and four mid-sized Italian banking groups have recently acquired important roles in several East European countries. In particular, Italian banks now hold market shares of around 20% in Croatia, Poland and Bulgaria (Banca d'Italia 2001, pp. 298 and 304).

[20] Six of the eight largest Italian banking groups (by assets) have at least one large European financial intermediary among their substantial shareholders. Even when this gives rise to cross-shareholdings (as it does in at least two cases), the foreign intermediary enjoys asymmetrical power.

This picture would appear to justify the doubt raised at point *c*) above: has Italian banks' income from services in recent years been fueled by insufficient price competition? To show that the M&As of the nineties did not diminish competition, in Section 3 I examined the traditional activities of lending and deposit-taking and the spread between lending and deposit rates but not the composition and terms of sale of non-traditional services. Considering that Italian banks' income from services has surged while their role in high-margin activities has been shrinking, I would have to remedy this omission. Unfortunately, the available empirical evidence just allows for a few remarks.

The data confirm that two retail activities, namely wealth placement and asset management, account for more than 75% of Italian banks' very substantial income from non-traditional services (ABI 2001, pp. 51-68; Banca d'Italia 2001, p. 322). In these two activities Italian banks have squeezed out non-bank intermediaries, and have thus acquired an overwhelming share of ownership (between 92% and 94% in the last three years) which exceeds the nonetheless high level prevailing in the other countries of continental Europe. Moreover, at least one type of service has been characterized by "both lack of transparency and incentives to operate for interests other than those of the customer" (Consob 2001, p. 35; see also p. 111). And there is some evidence that the Italian financial system is distinguished by a prevalence of high-cost active fund management and a dearth of low-cost, passively managed funds. In light of all this, it is legitimate to ask whether the supply of non-traditional services by banks is not based on insufficient price competition, as often happens in fast-growing markets.

If this doubt were substantiated by empirical findings (which to my knowledge are not currently available), in the Italian case the effects of consolidation on competition would be different from those suggested by Berger, Demsetz and Strahan (1999): the link between concentration and market power would not exist for traditional banking services but would exist for more sophisticated financial services (even if limited to retail business). The consequence would be a sufficient degree of competition in the market for traditional banking services, with positive effects on corporate debt contracts (especially at short term), alongside the persistence of monopoly rents in the market for asset management, with adverse effects on households' net fi-

nancial yields. Among other things, this would raise the theoretical problem of analyzing the behavior of multi-product enterprises, such as banks, that operate both in competitive markets with standardized activities and in segmented markets with complex activities involving different (and not always transparent) risks for buyers.

But bank mergers and ownership reallocation in Italy have had far stronger negative effects on market competition than the possible repercussions we have just examined. In the specific but crucial market for property rights, these two processes have distorted competitive relationships to the point of causing a structural market failure. In particular, they have: *i)* tightened the mesh of cross-shareholdings both between major banking groups and between medium-sized/large banks, creating an inefficient spiderweb of ownership;[21] and *ii)* placed at the center of this web a small number of major shareholders prominent among which are peculiar non-market institutions, i.e. the Italian bank-derived foundations. On these two points there is ample empirical evidence, summarized in the maps of the main shareholders of the major Italian banking groups at the beginning of 1998 and at the end of 1999 (Messori 1998; Inzerillo and Messori 2000). Let me recall the principal conclusions reached and show why the developments of the last two years have aggravated the situation at least as far as the major banking groups are concerned (see Figures 3, 4 and 5).

At the beginning of 1998, given the ten largest Italian banking groups (plus Mediobanca), half of them (San Paolo-IMI, Cariplo, Banca di Roma, Monte dei Paschi, Unicredito) had a core of controlling shareholders, with one or more foundations as the major shareholder; three others (Banca Commerciale Italiana, Credito Italiano, Mediobanca) were privately owned and the remaining three (Banca Nazionale del Lavoro, Banco di Napoli, Mediocredito Centrale-Banco di Sicilia) were still controlled by the state (Figure 3). At the end of 1999, the subset of state-controlled banks was empty but only two out of the new consolidated ten banking groups (including Mediobanca) were privately owned; eight of them (Banca Intesa-Banca Commerciale, Unicredito Italiano, San Paolo-Imi, Banca di Roma-Banco di Si-

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[21] For the sake of brevity and owing to the lack of definitive data, the examination is limited here to the ownership structure of the major banking groups and Mediobanca.

FIGURE 3

OWNERSHIP STRUCTURE IN THE ITALIAN MAJOR BANKING GROUPS (March 1998)

Figure 3

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Commerzbank AG

Source: Messori (1998).

cilia, Monte dei Paschi, Banco di Napoli, Banca Cardine, Mediobanca) had a hard core of controlling owners and one or more foundations as the major shareholder (Figure 4). Over these two years (1998-99) the web of interlocking shareholdings, which at the start of the period already embraced the banks under the foundations' control, the groups in the private sphere and many groups belonging to both, was transformed into a single 'galaxy' comprising all but two banks (Banca Nazionale del Lavoro and Banca Cardine). In other words, at the end of 1999 around 80% of the aggregate of the nine largest banking groups (plus Mediobanca) was enmeshed in a web of reciprocal control. At the center of the web were the four largest bank-derived foundations, a few private Italian non-bank enterprises (in particular, Assicurazioni Generali which is the main Italian insurance company, and three financial companies of the Agnelli group) and six of Europe's largest financial intermediaries.[22]

Far from becoming simpler, the ownership structures of Italy's major banking groups have grown even more tangled in the period spanning 2000 and the first months of 2002 (Figure 5). The links, which at the end of 1999 involved eight banks and Assicurazioni Generali, now involve nine and have strengthened. The description offered above is therefore all the more appropriate: even more than two years ago, Italy's major banking groups (plus Mediobanca) constitute a sort of galaxy so dense as to make real competition in the market for ownership rights impossible but not sufficiently structured to produce a bank able to compete in European and world markets. The financial nucleus of the galaxy consists of Intesa-BCI, San Paolo-IMI and Cardine, Unicredito Italiano, Banca di Roma, Mediobanca and Assicurazioni Generali; its outer belt counts Monte dei Paschi, Banca Nazionale del Lavoro and Antonveneta. The four major bank foundations, the Agnelli group and the six large European financial intermediaries continue to preside over this galaxy and hold it together. The only large, new Italian banking group remaining outside it is Banco Popolare di Verona e Novara.

[22] Note that the six European financial groups did not try to acquire full control of the Italian banks by means of market transactions. Perhaps discouraged by the lack of contestability of Italian ownership structures, they limited themselves to participating in the web. Italy's major banking groups thus risk suffering the worst form of passive internationalization, i.e. not becoming crucial parts of global or super-regional banks but also not enjoying the autonomy needed in order to play an active role in the European markets.

FIGURE 4

OWNERSHIP STRUCTURE IN THE ITALIAN MAJOR BANKING GROUPS (December 1999)

Figure 4

Source: Inzerillo and Messori (2000).

FIGURE 5

Figure 5

OWNERSHIP STRUCTURE IN THE ITALIAN MAJOR BANKING GROUPS (April 2002)

Crédit Agricole

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et Consegnations

## 5. Conclusion

We have seen that the consolidation and ownership reallocation of the nineties were rapid and positive for the Italian banking system. Confirming the theoretical limits of the traditional 'structure-conduct-performance' hypothesis and the empirical fragility of the associated correlation between concentration and market power, the evidence shows that Italian bank M&As were *accompanied* by decreased segmentation of the market in traditional banking services. Unlike the contradictory empirical findings on consolidation in other banking systems, the evidence also shows that M&As in Italy were *accompanied* by gains in operating efficiency and a rise in profitability toward the best levels in Europe.

Yet it would be incorrect to consider the more efficient functioning of Italian banks strictly as an outcome of consolidation and ownership reallocation. To begin with, these two processes were facilitated by radical changes in the legal framework, which at least reinforced their positive effects. In addition, they produced significant negative consequences, including: 1) greater inefficiency of the market in bank ownership rights; 2) reproduction of the limits of corporate organization and governance of Italy's major banking groups; 3) a further weakening of Italian banks' corporate finance and investment banking activity, and the possible introduction of restraints on price competition in the domestic market in asset management.

These three negative factors constitute as many obstacles to the Italian banking system's fully recovering competitiveness in Europe, for they imply that Italian banks today can count on only two elements of comparative advantage: *i*) strong roots in the local market, and *ii*) a position of strength in asset management activities in Italy, sustained by the existence of a large stock of financial wealth previously invested primarily in government securities. Not only are these two elements strictly domestic in nature, but they are also fragile inasmuch as they are destined to be eroded by informational technology and the evolution of the market. The growth of mixed distribution channels coupling online 'contacts' with the traditional branch network and the spread of standardized forms for supplying asset management services and managing the related risk diminish the advantages of a geographical base, even if they do not erase them. The in-

creasing maturity of asset management markets, bringing slower rates of growth, tends to eliminate the constraints on price competition and also to reduce profit margins.

If the Italian banking system fails to offer an innovative response to the weakening of its factors of comparative advantage,[23] it will be destined to operate in a sub-European regional dimension. That is, the largest Italian banking groups will be unable to win appreciable room in the European financial market and will fall back on defending their margins of competitiveness in the national market. Their competitors will be neither global players nor European super-regional banks but the variegated set of local Italian banks. If this scenario is to be avoided, a necessary even if not a sufficient condition is the launch in Italy of a third phase of consolidation and ownership reallocation, one that strengthens both the country's local banks and its major banking groups. In this third phase it will be necessary above all to build up a truly private ownership structure – i.e. under the control of for-profit shareholders of a nature consistent with efficient forms of corporate governance. It is a question of building banking groups of European caliber not only and not even mainly by size but in terms of their organizational form, their business plans and the range of services they offer.

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[23] The continual expansion of traditional distribution channels reinforces the worries in this regard.

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