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THE BANKING SYSTEM AND SAVINGS ALLOCATION IN ITALY

Alfonsina Iona, Leone Leonida and Damiano Bruno Silipo

Introduction

It is well known that banks play an important role in the economic growth of bank-oriented economic systems such as the Italian one. The Italian banking industry is in fact the main financial sector in Italy, as it represents 82 per cent of total financial activities (and 24.3 per cent of GDP). Although, by the end of 2009 the total loans of institutional investors, such as insurance companies, investment funds, pension funds and investment management companies, were about 11.8 per cent of GDP, the Italian capital market was still playing a minor role in boosting Italian economic growth. Despite the merger between Borsa Italiana SPA and the London Stock Exchange and the efforts made to create a segment of the market for small and medium-sized companies, by the end of 2009 Borsa Italiana registered just 291 listed companies, with a capitalization rate of 29 per cent of GDP. This evidence shows that savings allocation and growth perspective in Italy depend heavily on the banking system.

Aware that competition increases quality and reduces prices, throughout the nineties European governments implemented a number of reforms in the banking system in order to create a common credit market. An important step in this legislative process was the implementation of the Second Directive for Banking Coordination in 1992 (Seconda Direttiva di coordinamento bancario, 1992), which allowed European Union banks to open branches in other EU countries. As a consequence of this and other European directives, the Italian banking system was also involved in a period of restructuring that deeply changed its nature. From 1993 an intense mergers and acquisitions process started along with the privatization of the biggest public banks. Italy became second in Europe after Germany in terms of banking mergers. As a result, over the period 1990–2009, the number of banks fell from 1,176 to 788. Mergers have led to the integration of local credit markets via the start-up of banking groups, and the reduction in the number of independent banks. This, in turn, has changed the ownership structure of the banking system (Messori, 2002; Guiso et al., 2006).

This chapter investigates the effect of the change in the ownership structure on savings allocation and on the efficiency of the Italian banking system. The main conclusion of this
investigation is that competition and efficiency in the Italian banking sector are lower than those of similar financially developed countries, despite the strong process of reform in the Italian banking sector. Italian banks have the highest cost of banking services in Europe. This result is mainly due to cross-ownerships among the major Italian banking groups. In addition, our chapter studies another anomaly of the Italian financial system: the existence of massive controls on investment management companies (SGR) by Italian banks, which cause further distortions to savings allocation. Finally, we argue that poor functional efficiency in the Italian banking system prevents the banking sector from boosting Italian economic growth.

The chapter is structured in three parts. First, we compare the level of cost of banking services and the degree of efficiency of the Italian banking system with those of other European countries. Second, we analyse the determinants of banking inefficiency, such as ownership structure of Italian banks. Third, we study the characteristics of the savings allocation in investment management companies. Finally, we make some concluding remarks.

Costs and efficiency of Italian banks

The mergers and acquisitions (M&A) process in the Italian banking system since the nineties has led to the setting-up of few large banking groups able to exploit economies of scale and scope in the sector. This is the reason why the current structure of the Italian banking system is characterized by the coexistence of few large banking groups, operating both in Italy and abroad, and many small banks, segmented by market area or customers’ needs and operating mainly in local credit markets.

A first helpful criterion for evaluating the effect of this M&A process is to compare the costs of banking services in Italy and other similar developed countries. In 2003, the annual worldwide survey of current account fees by Cap Gemini and the European Financial Management and Marketing Association (Efma) showed the average price (206 euros) of some core banking services (cheque and cash payments, account management, down payments and bank overdrafts) charged by the six biggest Italian banks was higher than that (109 euros) of the other countries analysed in the survey: Belgium, Canada, France, Germany, Netherlands, Norway, Sweden, the United Kingdom and the United States.

In 2007 consumer protection organizations received complaints from citizens about the rule on the symmetry of rates not being applied properly: banks did not adjust active and passive interest rates to the new official reference rate (tasso ufficiale di sconto).

The unadjusted rates badly affected families, especially low-income ones. In fact, the European Central Bank (ECB), according to consumer protection organizations, increased the cost of money five times in one year and consequently Italian banks raised fees on mortgages, loans and bank credits without raising rates on deposits, such as current accounts and savings accounts. Furthermore, banks would have charged customers a higher fee to pay off a mortgage than the fee agreed by the ABI (Associazione bancaria Italiana).

In April 2010, at the Senate Finance Committee, Antonio Catricalà, president of the Antitrust Committee (Il Sole24 ore, 17 April) claimed that fees and tariffs of different banking services were higher than those applied in a competitive market and similar to those applied in an oligopolistic market. He also said that new fees replacing overdraft commissions increased costs especially for account holders. Therefore, in order to reach a good level of competition, he claimed it was necessary to increase the mobility of clients and to reinforce consumers’ and small and medium-sized firms’ bargaining power. At the end of 2010, the Bank of Italy’s representative at a Senate hearing showed that the average cost of a current account had remained
stable in recent years, with a small decrease in the fees for cash withdrawals and payments, but with an increase in other variable expenses, including fees for the use of overdraft services.

Moreover, Michael Barnier, the European Union commissioner responsible for the Internal Market, recently announced the implementation of an investigation into disparity sources for costs of banking services, pointing the finger at Italy, where the average cost per customer is 246 euros per year against 43 euros in Netherlands. The vigilance commissioner for prices (Garante per la sorveglianza dei prezzi) expressed worries about complaints about the lack of transparency and clarity in the increase in the management costs of current accounts. He announced an investigation on costs paid by customers in the banking industry, in order to verify the single cost charged to clients and the correct application of rules on overdrafts.

Thus, by comparing levels of costs and services provided to customers across countries, we can conclude that Italian banks must still work hard to reach the same efficiency level as that of other developed European countries, even if legal and structural reforms have taken place only in recent years in the Italian banking sector.

In principle, the high cost of banking services might be compensated by a lower differential between active and passive interest rates. However, as we have mentioned, in the Cap Gemini research in 2003, Italy has a positive relationship between spreads and costs of banking services, whereas in the other countries in the sample (Belgium, Canada, France, Germany, Netherlands, Norway, Spain, Sweden, the United Kingdom and the United States) this is not the case. The same research shows that, after Germany, in 2003 Italy showed the highest spread of all those countries. Moreover, EUROSTAT data show that from 1996 to 2004 the cost of banking services rose in Italy by 78 per cent compared with the 28 per cent of the fifteen EU countries.

Competence and ownership structure in the Italian banking industry

The deregulation process in the nineties, started as a consequence of EU directives, aimed at increasing competition in the banking industry. In fact, it led to an increase in both the number of banking counters and ownership concentration in the Italian banking system, through an intense mergers and acquisitions process. Therefore, it is important to understand whether and how this increasing concentration has affected competitive mechanisms in the Italian banking system.

The theoretical relationship between competition and concentration is ambiguous. On the one hand, it is argued that the degree of competition in a market is inversely correlated to the degree of ownership concentration. On the other hand, it is stated that high ownership concentration does not necessarily lead to a lower degree of competition, but it may lead to an increase in the industry’s efficiency. The idea underlying this strand of research is that a more efficient firm can increase its share price through mergers more than an inefficient one. This explains why the higher the concentration, the lower the price in the sector. In Italy over the period 1995–2006, 476 banks were involved in mergers and acquisitions, which accounted for 70 per cent of total activities in the system.

However, while mergers are made to allow banks to exploit economies of scale and scope (Berger et al., 2001; Berger, 2000), a more efficient firm does not necessarily impose a reduction in the level of price for customers. Therefore, evaluating the effect of mergers on prices means taking into account these two potential outcomes, along with the ability of potential competitors to enter the market and the kind of market (local, national, international), which may affect that relationship.
The first way to estimate the effect of mergers on banking competition is to evaluate the trend of interest rates on deposits after the merger. If the merger improves efficiency, we might expect that banks involved in the merger process will increase interest rates on deposits after the merger. Conversely, if the merger increases banking competition, we might expect a decrease in the interest rates on deposits. This latter can be taken as a signal that the merger is a mechanism that distorts perfect competition.

Focarelli and Panetta (2003) show that mergers in the Italian banking system led to an increase in interest rates on deposits immediately after the merger but to a decrease in the period thereafter. The authors conclude that mergers in the Italian banking sector increase market power only in the short term; in the long term, they instead cause a higher level of competition.

Angelini and Cetorelli (2003) also find that, two years after a merger, interest rates on deposits increased and they conclude that the ownership concentration in the Italian banking system in the 1990s increased competition. This conclusion is supported by Coccorese (2002), Sapienza (2002) and Cerasi et al. (2009). In particular, the research by the last mentioned shows that the increase in the level of competition is due to the fact that a merger creates a bank able to compete with other banks operating in the local markets.

The second way to estimate the effect of mergers is to consider the persistence of extra profits after the merger. This is because the persistence of non-competitive profits implies high market power where entry barriers prevent profits from converging to the zero long-term equilibrium level (Mueller, 1977).

In line with this strand of research, Messori shows that over the period 1990–7 the consolidation and reallocation of ownership structure, which has seen the setting-up of five big banking groups (IMI, BNL, Mediocrédito, Mediobanca, San Paolo di Torino), produced an increase in efficiency and competition in the banking sector. However, since 1998 there has been an increase in revenue for the big banking groups, i.e. non-competitive profits (Messori, 2004). This result supports the hypothesis that the concentration of ownership structure has not been efficient from a competitive point of view even in the long term. Accordingly, Agostino et al. (2005) show the existence of a significant correlation between the persistence of profits and ownership concentration, for a sample of Italian banks over the period 1997–2000.

By investigating the potential sources of the positive relation between concentration and market power, Messori (2001 and 2004) shows that mergers and acquisitions led not to the setting-up of a few independent banking groups, but to a situation in which a small number of shareholders hold an important share in almost all the big banking groups: so-called cross-ownership (see also Inzerillo and Messori, 2000). These cross-ownerships have involved the biggest banking groups (Banca Intesa Unicredit, San Paolo IMI-Banco di Napoli, Banca di Roma-MCC, Banca MPS, Banca Nazionale del Lavoro, Banca Cardine, BIPOP-CARIRE, Banca Lombarda e Piemontese, CdR Firenze, Carinord, Credem) with shares held in many other banks too. In line with this, Trivieri (2007) shows that, over the period 1997–2000, small Italian banks involved in the cross-ownership process exhibited non-competitive behaviour.

Results on the effect of mergers on competition are ambiguous. On the one hand, trends in deposit rates show an increase in banking competition. On the other hand, the persistence of extra profits shows a decrease in banking competition. As far as the spread between active and passive rates applied by Italian banks from 1992 to 2004 is concerned, a fall in that spread from 9.4 per cent to 4.9 per cent was observed. This reflects to some extent the increase in the level of competition that has characterized the Italian banking sector since 1992. Further, the Italian spread is higher than the average spread in Europe, which shows Italian banks’ greater market power with respect to other European countries (Silipo, 2009).
In light of this, the main issue for the Italian banking system is evaluating whether these changes are enough to bring the Italian financial system to the same level of efficiency as other developed countries. Our chapter casts some doubts on the effectiveness of these changes.

First, as we have mentioned above, the Italian banking system charges high prices to customers. Second, although the consolidation process has increased the efficiency of banks and competition in their traditional activities, the level of efficiency in non-traditional activities, such as corporate finance, investment banking and portfolio management, has not improved. Third, we have observed an increase in operating efficiency, but not a rise in the functional efficiency of Italian banks (Silipo, 2009), especially in the South of Italy (Mezzogiorno), where the functional distance between banks and the local economy is bigger and plays an important role in the development of the area (Alessandrin et al., 2005).

Investment management companies: structure and effects on savings allocation

It is reasonable to think that the cross-ownership characterizing Italian banks is related to the high costs for customers. Also, the Italian financial system is unique not only because of cross-ownership, but also because of the nature and behaviour of the investment management companies (IMCs). The majority of IMCs are controlled by insurance or banking groups. This contributes not only to raising barriers against foreign and internal competitors and exploiting revenue positions, but also to subordinating IMCs to the strategies chosen by their owners, by affecting their organizational autonomy and potential innovation process.

Moreover, mergers and acquisitions in recent years have not increased efficiency in the asset management industry. As a consequence of this, a number of facts can be observed, such as the coexistence of IMCs with different and independent strategies, but belonging to the same parent company (see the Eurizon and Fideuram case), the presence of many small and medium-sized IMCs controlled by a unique owner (see the case involving many IMCs related to banking groups or popular banks), the merger of IMCs with a different degree of specialization, but belonging to a new consolidated banking group and so on (Messori, 2010b).

Today, more than 90 per cent of asset management products are distributed through banking channels and, as a consequence of the IMCs’ ownership, the asset management industry has contributed 11.1 per cent to the earnings margin (margine di intermediazione) in a sample of fourteen Italian banking groups, according to an Associazione bancaria Italiana survey (2007). The existence of cross-ownership between financial institutions and IMCs allows banks to earn on a savings perspective, a cross income, recovering potential dissipation of profits because of lower competition in traditional activities.

Although it is difficult to estimate the consequences of IMCs’ ownership for savings allocation in Italy, some indicators show the inefficiency of IMCs in the allocation of Italian households’ savings.

A first indicator of this inefficiency is related to the savings allocation among different types of funds. As an example, Italian equity funds boosted their performance in 2000, during the ‘Bubble Burst’. Furthermore, over the period 1999–2000, Italian underwriters of equity funds invested significantly in markets (Nasdaq 100 and European markets) that were suffering the greatest losses. On the other hand, a large proportion of underwriters did not invest in equity funds over the period 2001–2, when equity markets performed poorly. Similarly, they did not invest in the following years, 2003–6, when equity markets performed better, losing in turn any gain they could have made during this period. On the other hand, the net collection of bond funds was positive from 1998 on. This means, according to Messori (2010a), that Italian...
savers invested their money in bond and liquidity funds during the period of the last stock exchange boom.

There are many causes of this inefficient savings allocation. The first comes from the supply side: Italian banks’ increasing financial need led them to increase the net issue of bonds and to exploit IMCs as a distribution channel to place their products in the market.

A second cause comes from the demand side. The Bank of Italy’s survey on Italian households’ wealth and income (2008) shows that Italian families are not well informed about financial services available in the market. About one-third of them are not able to read an account statement; more than half are not able to understand the importance of the diversification of investments and two-thirds are not able to distinguish the degree of risk related to bonds and stocks (see Visco, 2010). However, in addition to this lack of knowledge among investors, there is the increasing complexity of financial products, which increases the degree of asymmetric information between buyers and sellers and allows banks and IMCs to easily affect buyers’ decisions.

Empirical evidence (Mediobanca, 2007; Barucci, 2007; Petrella, 2006) shows that over the last decade Italian investment funds performed badly. In particular, they exhibited lower levels of performance than their benchmarks, especially in the case of bond funds. Barucci (2007) shows that over the period 2004–6, investment funds in Italy had a negative alpha value (performance net of distribution costs), despite a better gross performance than their benchmarks. In other words, distribution costs for IMCs decreased efficiency to a lesser extent than that of their benchmarks. In fact, comparing TER (total expense ratio) of Italian funds with that of European funds, the Italian TER seems to be higher than the European average. Further, Barucci (2007) shows the existence of a reverse relationship between extra performance and the level of bank fees. Distribution costs are crucial for savings allocation: Italy is second in European countries in terms of distribution costs, despite a level of production cost slightly lower than the European average.

Moreover, the financial crisis negatively affected the asset management industry. In fact, from 2006 to 2009, the wealth of the Italian asset management industry suffered heavy outflows and losses were greater for Italian investment funds compared with foreign funds: the ratio between the wealth of Italian and foreign funds reduced significantly from 2000 to 2010 (Messori, 2010a). Because of this, the Italian asset management sector has been reshaped and power transferred from Italian funds to foreign funds.

The scenario looks worse if we take into account that IMCs have replaced institutional investors (pension funds, insurance companies) in the Italian financial market because of their historical weakness. Nevertheless, the lack of well-performing institutional investors and the inefficient savings allocation of IMCs did not allow the exploitation of the high saving propensity and the high net financial wealth of Italian households in order to cope with the Italian economy’s decline in the last two decades.

In this respect, it is crucial to investigate the efficiency of the Italian banks in savings allocation. The analysis of the functional efficiency of the Italian banking system is beyond the scope of this study (for further details, see Silipo, 2009). We can only look at whether Italian banks play the role of social accountant (Stiglitz and Weiss, 1988) efficiently, as in this case, the economy should be characterized by a banking system supporting the production process and innovation.

A first index of banking support for the production system is the ratio between banking loans provided to the private sector and deposits. In 1997, this ratio was 100 in the Eurozone and 105 in Italy. Ten years later the same index was about 177 in Italy, against 120 as the European average (see Messori, 2010b). Although this evidence might be due to the contraction of savings...
in Italy over the same period, data on loans/GDP ratio seem to confirm the existence of wide banking support for the production system. In fact, the ratio between banking loans to the private sector and GDP has registered a steady increase since 1997, and shown the same tendency, although at a lower rate, since the financial crisis (see Panetta and Signoretti, 2010).

We can conclude that loans growth over the last decade cannot be associated with a recovery in the Italian economy. Of course, there are many reasons for Italy's economic decline. Insufficient innovation, poor public sector performance, and inadequate development of and performance by the financial sector are some of them. This chapter has only investigated whether the inefficient allocation of bank loans or their inadequate allocation to more innovative investments can be considered as one of the causes of that decline. Strictly speaking, despite the Italian banks' good support for the production system, the slow speed of the Italian economy raises the question of whether the banking system has been selecting and implementing effectively investment projects boosting growth or whether it has just used households' savings to finance less remunerative investments.

Concluding remarks

The Italian banking system was been involved in an intense regulation process in the 1990s which led to a substantial restructuring of the banking sector. In our study, we have evaluated the effect of this change on savings allocation and efficiency of the banking system. There are two main conclusions to be drawn from our study.

First, the level of competition and efficiency in the Italian banking system appears to be far from that of more financially developed countries, despite the competitive pressure because of the liberalization of banking counters. This may be due to the higher cost of services charged by Italian banks with respect to the European average.

Second, cross-ownership among banks is not the only distortive factor characterizing the Italian financial system. Other factors are the behaviour and the nature of the investment management companies, which are fully controlled by the Italian banks. This negatively affects the efficiency of IMCs in the allocation of households' wealth, raises barriers to internal and foreign competitors, gives the chance to exploit revenue positions and finally, subordinates IMCs to the strategies chosen by their owners, which affects their innovation processes.

Finally, we argue that the high level of competition in the banking industry has increased the propensity to lend money but has not raised the banks’ functional efficiency, which would allow selecting and implementing more profitable investment projects, and then boosting Italian economic growth.

Notes

1 A classic paper on this topic is Berger et al. (2004).
2 These sources of decline are analysed, for example, in Toniolo (2004) and Messori and Silipo (2012).

Bibliography


