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**Article**

## Restructuring in the banking industry with implications for Europe

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## ABSTRACT

*Set against the background of a rapidly consolidating financial sector, this paper explores the main forces that are driving this process. Acknowledging that the search for scale and scope economies is one of them, the paper emphasises that the empirical evidence in support of such economies is mixed, at best; while scale and scope economies exist, in principle, they are difficult to attain in practice. The paper considers strategic positioning in an uncertain and rapidly changing environment a more important factor: by expanding scope (and scale), financial institutions acquire options to venture into new activities. An implication of this strategic-option explanation is that consolidation, scope expansion in particular, will partially unravel as and when uncertainty declines and competition forces financial institutions to discover their true competitive advantages.*

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# Restructuring in the banking industry with implications for Europe

## 1. Introduction

The financial services sector is restructuring and consolidating with considerable force. Most striking is probably the ever-escalating scale of mergers in banking. In just the last few years, in the United States, mergers have led to a consolidation of money centre banks (e.g. the Chase Manhattan and Chemical Bank merger, prior to their subsequent merger with JP Morgan) and the emergence of regional powerhouses (e.g. the expansion strategies of BankOne and Nationsbank and their mergers with, respectively, First Chicago/NBD and BankAmerica). In Europe, mergers have also been prominent. While cross-border mergers are relatively infrequent, domestic mergers typically involve large universal banks and are often spectacular. Noteworthy examples include the marriage of Union Bank of Switzerland (UBS) with Swiss Bank Corporation and the acquisition of Paribas by Banque Nationale de Paris.

The merger wave has not only increased scale but has generally also broadened the scope of many banks. Major investment banks are redefining their domain by offering traditional commercial banking products, such as commercial and industrial loans, and by moving into retail brokerage. The union of Salomon Brothers (investment bank) and Smith Barney (broker) within Travelers underscores the scope-expansion in the industry. Similarly, Credit Suisse bought the US stockbroker DLJ, and UBS bought PaineWebber. The spectacular cross-industry merger of Travelers (insurance) and Citicorp (banking) also brings the insurance activities together with bank-oriented financial services. Similarly, Credit Suisse expanded into insurance by acquiring Winterthur.

Why are banks consolidating so much and often choose to expand scope? The empirical evidence on scale and scope economies in banking is far from conclusive. It is questionable whether these economies are large enough to justify consolidation and scope expansion on the scale that we have observed (see Berger 1997, Berger *et al.* 1993). Moreover, ample research in corporate finance points at the existence of a diversification discount. On average, diversification seems to destroy value. At the same time, there is substantial evidence that firms that have refocused their activities have experienced improvements in operating performance and stock returns (see John and Ofek 1995, Comment and Jarrell 1995). Against this background, one may wonder: why are so many mergers and acquisitions taking place in the industry?

This study aims to address this question and related issues. I will examine the existing empirical evidence on scope and scale economies in banking. In a recent survey paper, Berger *et al.* (1999) evaluate the extensive, primarily, US evidence. Their findings are, if anything, quite sobering about scope and scale economies. However, most studies they report on are quite dated. Therefore, an important question is whether this empirical evidence is suitable for explaining the current consolidation wave. While I will conclude that the existing evidence is of some value - and I will cite some newer evidence that is of greater value - I doubt that it is really helpful for understanding the current restructuring in banking. Several issues play a role here. Apart from econometric and sample-selection issues, and possibly fundamental changes in underlying circumstances, the overriding issue is - in my view - that strategic



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considerations are the key forces behind the current consolidation wave. As I will argue, strategic considerations may have little to do with true scale or scope economies. But learning, first-mover advantages, and strategic advantages of market power may explain the current consolidation wave and the broad scope of many of the players in the industry.

Strategic positioning might currently be the rule of the game, constituting an optimal response to the uncertainties and rapid - as well as unpredictable - changes financial institutions are facing today. Consolidation might then be an evolutionary phenomenon, about to be followed by a new type of repositioning when the uncertainties become more manageable. In any event, as competition is growing, margins are declining, and costly scope-expanding strategies possibly becoming unsustainable, the viability of a broad wait-and-see strategy may soon be over.

The organisation of this paper is as follows. In Section 2, I discuss scope and scale economies in banking - their sources, empirical evidence for them, difficulties in realising them, and scale and scope considerations that may become important in future. Section 3 introduces strategic considerations, in particular, the importance of strategic positioning. In that section, I will also discuss the relevance of these insights for the ongoing restructuring in the European financial services industry. Finally, in Section 4, I conclude by offering some thoughts on the (to be expected) disaggregation of the value chain, with a more prominent role for alliances and joint ventures. I will also discuss some political considerations, particularly in the European context, that may have an important impact on the ongoing restructuring of Europe's banking industry.

## 2. Scope and scale economies in banking

### 2.1 Introduction

*Economies of scale and scope are supposedly behind consolidation in banking - but are they truly present?*

Scale and scope economies are often cited as one of the main reasons behind mergers and acquisitions in banking. But are scale and scope economies truly present? And could they rationalise the current restructuring in the industry? In this section, I first seek to identify the main sources of scope and scale economies (Section 2.2). I then summarise the empirical evidence on scale and scope economies (section 2.3); discuss why such economies - to the extent that they exist - may be hard to attain in practice (Section 2.4); and conclude with some observations on the activities that seem to be most susceptible to scale and scope economies (Section 2.5).

### 2.2 Sources of scope and scale economies

Scale and scope economies essentially rest on (i) advancements in information technology, (ii) reputation and marketing/brand name, (iii) financial innovation, and (iv) on diversification. Let us look at these sources for potential scale and scope economies one-by-one.

**Information technology** is most likely of great importance. Recent developments in information technology facilitate a more efficient and effective use of databases over a wide range of services and customers. That is, client-specific information may allow for scope economies and facilitate a competitive advantage to financial institutions that offer a range of services to their clientele. Similarly, possibilities for reusability of information across customers may have increased.

Information technology helps in identifying related client needs. Scope economies therefore apply to all products that could be sold to the same client group. Examples for bank-insurance conglomerates include: life-insurance features in mortgages, asset management/private banking services combined with life insurance, commercial credits in combination with industrial risk insurance, and export financing together with export credit insurance.

This also points at benefits related to distribution networks. Advancement in information technology may facilitate scale economies in running a sizable distribution network. Simultaneously, scope economies might become much more visible. For example, information technology facilitates an increasing array of financial products and services to be offered through the same distribution network. Customers may attach value to one-stop shopping, encouraging some financial institutions to offer a broader package of financial services tailored to particular customer categories.

*Advancements in information technology create the potential for scale and scope economies, not only because modern IT allows to run a larger distribution network.*

Finally, developments in information technology may affect the possibility of control, thus facilitating the management of a bigger organisation. But it also true that sizable investment in information technology is needed to help make scale and scope economies become a reality.

**Reputation and brand name/marketing** also offers potential for scale and scope economies. Scope benefits may be present in the joint marketing of products to customers. Brand image is partially marketing related but is also linked to the notions of trust, reputation, and confidence. These notions play an important role in the financial services industry. Increasingly, financial service providers offer services that crucially depend on their reputation. For example, the growing importance of off-balance sheet claims puts great emphasis on the ability of financial institutions to honour these contingent liabilities. But also the success of modern, virtual distribution channels (Internet) may depend crucially on reputation. Under certain conditions, increasing scale and scope allows financial institutions to capitalise more on their reputation. That is, a wider scope (and/or scale) may help a financial institution to put its reputational capital at work (see Boot *et al.* 1993).

A concrete example here is the Dutch bank-insurance conglomerate ING that offers direct banking services in Spain, for example. In advertisements, the name of ING is linked explicitly to Nationale-Nederlanden, ING's insurance subsidiary, a well-known and respected institution in Spain.<sup>1</sup> Using a brand name established in one line of business when entering another is also used by other players (e.g. supermarkets leveraging their brand name when offering financial services).

**Financial innovation** as a source of scope and scale economies is a two-edged sword. On the one hand, one could argue that larger institutions are less likely to innovate due to the inherent bureaucracy. This might be true, but that is a governance issue. On the other hand, *ceteris paribus*, larger institutions can better recoup the fixed costs of financial innovations. This is because innovations can be marketed to a larger customer base and/or introduced in a wider set of activities. In fact, for financial innovations, scale and scope might be particularly

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<sup>1</sup> The ING example also shows the possible sharing of marketing expertise between insurance and banking subsidiaries. Banking subsidiaries have generally benefited from the extensive direct marketing expertise of the insurance arm. Furthermore, in the case of ING, the skills of Postbank (an ING subsidiary) in direct banking are also relevant.

important given the rapid imitation by competitors. Only for a short period of time does a true competitive advantage exist. In these circumstances, a wider scope and larger scale may help recoup the fixed costs in this short period of time. Economies of scale and scope resulting from financial innovations should also be seen in light of the first two sources of economies: a wider range of products offered to a large client base in combination with advanced information technology can provide superior information for the design of financial innovations.

Bank-insurance combinations could potentially be successful in leveraging each other's product skills. For example, insurance subsidiaries could benefit from derivative innovations coming from the banking arm. Similarly, securitisation skills developed in banking are heavily cross-used, and, more recently, several securitisation innovations have been motivated by particular needs in the insurance operation. A related argument for combining life insurance and banking is that it could augment the total asset management pool, and thus offer scale economies. While this might be true, more recently banks and insurers have learned that the asset management operation requires distinct skills and is not automatically profitable as a passive spin-off from other activities. Thus, synergies are present, but not necessarily dominant.

*The view that diversification is a source of scale and scope economies is controversial.*

**Diversification** means that financial institutions offer several products that might be close substitutes, for example pension-, life insurance-, and saving products. Combining these products and services under one roof makes institutions less vulnerable when savers substitute one of these products for other ones. This could be interpreted as a diversification benefit, but may also point at cross-selling benefits discussed in the context of benefits arising from the use of advanced information technology.

From a corporate finance perspective, diversification is a controversial argument. After all, investors in financial institutions could diversify; and why would a financial institution itself need to do this unless, of course, there are synergies and, thus, scope economies? Various frictions may help answer this question and, thus, explain the value of diversification. For example, diversification facilitates an internal capital market where cashflow generating businesses could help fund other activities that need funding. If raising external funds is costly, this may add value. Nevertheless, this might be a mixed blessing. Often the presence of internal capital markets invites cross-subsidisation of marginal or loss-making activities that could wipe out potential benefits. Having said this, it is also true that a low volatility in returns is considered very important in banking, suggesting some benefit of diversification.

A link can also be made to the proliferation of off-balance sheet banking. These activities involve a plethora of guarantees that lead to contingent liabilities. For such activities, the credibility of the bank to honour such guarantees is crucially important. One measure of this is a bank's credit rating. With the proliferation of off-balance sheet banking, ratings have become more important. If diversification helps in getting a better rating, the case for diversification is stronger.

Diversification benefits may also accrue on the funding side, and direct funding synergies may apply. To illustrate, the mismatch between assets and liability on a bank's balance sheet (short-term funding vs. long-term assets) might be the reverse from that of an insurer with largely long-term obligations. However, corporate finance theory suggests doubts as to the validity of these arguments.

**Table 1. Key sources of scale and scope economies and underlying synergies**

Source	Type of synergy	Example(s)
Information technology related economies	Revenue	• cross selling potential
	Cost	• fixed cost of IT • reusability of information: cross-sectional and intertemporal • scale economies in running distribution network
Reputation and marketing/brand name related benefits	Revenue	• acceptance of new distribution channels (internet) • cross-selling potential
	Cost	• fixed cost of marketing, branding
Financial innovation related benefits	Revenue	• superior innovations based on broader information set • better rent extraction due to bigger network
	Cost	• spreading of fixed cost of innovation
Benefits of diversification	Revenue	• avoid loss of turnover to substitutes • benefits linked to off-balance sheet activities
	Cost	• internal capital market

Table 1 summarises the main sources of scope and scale economies; it also indicates that synergies, which generate such economies, can be revenue-enhancing and/or cost-reducing. The examples shown in the table suggest that most of the potential for scope and scale economies arise from the distribution of financial products and services. The importance of the distribution network is clear and should be considered a primary source of scope and scale benefits.

*Most of the potential for scale and scope economies arise from the distribution of financial products and services.*

### 2.3 Empirical evidence on scale and scope economies

Scale and scope economies in banking have been studied extensively. A recent survey paper by Berger *et al.* (1999) concludes that, in general, the empirical evidence cannot readily identify substantial economies of scale or scope.<sup>2</sup> Scale economies could not readily be found beyond a relatively small size of banks as measured by total assets (i.e., beyond USD100 million up to USD10 billion in total assets). The story on scope economies is even more negative. Diseconomies of scope are quite prevalent. An important caveat is that this research largely involves US studies only. Contrary to banking in many other countries, US banking has historically been quite fragmented.<sup>3</sup> The mergers and acquisitions that were included in most studies took place in an environment where severe constraints existed on the type and geographic dispersion of activities. It is conceivable that these restrictions made it difficult to benefit from scale and scope economies (see also Calomiris and Karceski 1998). Moreover, most studies use data from the 1970s and 1980s. Since the structure, technology

2 See also Shaffer and David (1991), Cornett and Tehranian (1992), Mester (1992), Mitchell and Onvural (1996), and Clark (1996).

3 This is not really surprising. US banks faced substantial regulatory constraints on their activities concerning both the type of their activities (e.g. banks could engage in commercial banking or investment banking, but not both) and their location (e.g. limits on interstate banking). More recently, however, regulatory constraints have become less binding. This undoubtedly partially explains the surge in mergers and acquisitions.

and environment of banking has changed dramatically over the last decades, it is not clear whether insights from those studies readily apply today.

*Empirical evidence in favour of scale and scope economies is weak - but this may also reflect measurement problems.*

In any case, most empirical researchers in the field of industrial organisation will acknowledge that scale and scope economies are very difficult to measure. So, at best, very modest conclusions could be drawn from these empirical studies. The presence of largely inconclusive results should then not really be surprising. Moreover, inefficiencies in managing larger organisations may mitigate possible scale and scope benefits. This would be in line with the sizable literature on the diversification discount; Berger and Ofek (1995), for instance, found an average diversification discount of 13-15 percent. Berger (2000) further observes that managerial ability to control costs creates a differentiation in bank performance that may well dominate the potential scale economies. The difference between an average bank and the best-practice bank is about 20 percent (of the costs of the average bank), while scale economies in the 1980s were not more than 5 percent, but they are possibly larger today. Berger also argues that managerial ability may have an equally big impact on revenue efficiency.

What further complicates empirical research is that increasing scale and scope may facilitate market power and, thus, elevate profitability even if there are no scale and scope economies at all. This effect might be less important in inter-geographic market mergers. Moreover, alternative distribution networks - direct banking for instance - and the broadening and deepening of financial markets may have reduced the effective market power of locally concentrated financial institutions and, more generally, elevated the contestability of markets.

Another issue is that the level of aggregation in most studies is high and may obscure benefits of scale and scope. In particular, aggregation does not allow identifying what type of merger and acquisition involve scale and/or scope benefits. Cognisant of this problem, Flannery (1999) refers to recent research that suggests that mergers with both a geographic and activity focus are most value-enhancing.<sup>4</sup> This strongly suggests that in analysing scope and scale issues one should focus on the type of activity; this would allow investigating the scale economies in each activity as well as the scope economies associated with a particular product-mix.<sup>5</sup>

I now turn to the question of how the efficiency gains of scope and scale are actually measured. Earlier work - i.e., research produced up to, say, the mid-1990s - measured economies of scope, for instance, by comparing the cost of specialised single-product financial institutions to that of financial institutions producing multiple financial services. A typical study along these lines is Ferrier *et al.* (1993), which considers possible scope benefits of five closely related bank services, namely demand deposits, time deposits, real estate loans, instalment loans, and commercial loans. More specifically, the study compares the cost of fairly specialised banks to that of comparatively diversified ones. A key finding is that less than 3 percent of the banks in the sample showed scope economies,

4 The question remains as to what extent enhanced value is due to efficiency gains, as opposed to enhanced "value" due to increased market power.

5 Surprisingly, this type of research is yet hard to find. A lot of research has been done on potential conflicts of interest in universal banking (see, for example, Kroszner and Rajan 1994, Puri 1996, and Ramirez 2002). However, this research is of very limited interest for the issue raised here because it does not really focus on the complementarity between activities.



while 79 percent experienced scope diseconomies.<sup>6</sup> Other contemporary studies come to similar conclusions (Berger *et al.* 1987, Pulley and Humphrey 1993). The study of Ferrier *et al.* also showed that diseconomies of scope were more likely, the larger the bank was.

More recent studies rest on different efficiency concepts, profit in particular. Again, the results are inconclusive at best. In a typical study, Berger *et al.* (1996) focus on the benefits of jointly using deposits and loans, which are - in a sense - the benefits of one-stop banking. Theoretically, one can envision various benefits, such as lower transaction, search, and information costs. However, no profit efficiency enhancement was discovered. This does not necessarily imply that scope economies do not exist. It is possible that competition between financial institutions prevents banks from retaining the benefits. That is, competition might force institutions to pass on to consumers the surplus that scope expansion creates. But as a general conclusion, it is fair to say that scope economies are hard to realise. Illustrative in this respect is Saunders (2000); he lists 27 studies, of which 13 find diseconomies of scope, six find economies of scope, and eight conclude that scope is neutral to efficiency.

*Efficiency gains from scale and scope can be measured in different ways.*

Other studies seem to yield more positive results as to the cost and profit efficiency effects of expanding scope and scale. For instance, focussing on structural differences between financial conglomerates, universal banks, and specialised institution in Europe, Vander Venne (2002) finds somewhat higher cost and profit efficiency of conglomerates and universal banks. However, these efficiency differences cannot readily be translated into scale and scope economies. The banking industry is changing rapidly and the (traditional) inefficiencies in banking are coming under attack from competitive pressure and technological advances. Differences in efficiency may just reflect differences in the state of adjustment of these institutions, translating into temporarily diverging levels of X-efficiency rather than pointing to scale or scope economies.

Another approach to gauge efficiency gains is to assess how the market values them. Recently, DeLong (2001) has looked at the shareholder gains - that is, the immediate announcement effects - from focused versus diversifying bank mergers in the United States during 1988-95. He found that focused mergers (i.e. those aiming primarily at scale economies) - both on the level of activity and geography - had positive announcement effects. Moreover, focus in activities was shown to be more important, than geographical focus, albeit the latter was important as well.<sup>7</sup> Interestingly, activity-diversifying mergers (i.e. those aiming primarily at scope economies) had no positive announcement effects. These results point at the presence of scale rather than scope economies.

While the study of DeLong focuses on relatively small US banking institutions,<sup>8</sup> recent European evidence on much larger institutions confirms the desirability of geographical focus. Beitel and Schiereck (2001), analysing mergers between European financial institutions during 1988-2000, show that domestic mergers have - on average - significantly positive combined (bidder plus target) announcement effects, which were

<sup>6</sup> The sample covered 575 banks that participated in the 1984 Federal Reserve's Functional Cost Analysis Program.

<sup>7</sup> Geographical expansion in the United States often involves buying neighbouring (focused) retail banks, which allows for economies on IT systems, management processes, and product offerings. Relative to Europe, where geographical expansion often implies buying large universal banks across the border, fewer barriers to an effective integration exist.

<sup>8</sup> Market capitalisation of the bidder (target) approximately USD 2 (less than 0.1) billion.

weaker, however, in the last few years (i.e. 1998-2000). They also found that diversifying domestic mergers (particularly between banks and insurers) had on average a positive value impact. In line with this evidence, the Citigroup-Travelers merger resulted in an increase in the stock prices of both merger partners (Siconolfi 1998). Other European studies on bank-insurer mergers confirm the latter insight; for instance, Cybo-Ottone and Murgia (2000) find a positive effect on combined value. Overall, studies investigating the announcement effect on financial institutions that strive for scope economies point at positive effects of expanding scope - seemingly in contrast to studies focussing on cost or profit efficiency - but this may well reflect market power effects. However, the distribution of the value gains is often tilted against the bidder. Especially in cross-border bank mergers, bidding banks suffer a severe value loss while targeted institutions come out extremely well.

The results of the studies that focus on the announcement effects of mergers and acquisitions reveal the market's expectation of future cashflow. Two caveats should be emphasised. First, actual performance may differ from market expectations. As DeLong puts it, "Although the prior conditions to predict successful mergers may exist, their presence may be difficult to discern." This is particularly true for some of the mega-mergers that are observed today. A lack of data and potentially radical and unprecedented shifts in the structure of banking give little guidance in interpreting the value consequences of these mergers. As an example, the reported significant positive announcement effects associated with bank-insurance mergers may be difficult to reconcile with the current market sentiment. Second, mergers and acquisitions may change the structure and dynamics of the industry, and the possible increase in the market value of bidders and/or targets could measure a variety of effects other than those related to the expansion of scale and scope, including those linked to a perceived increase in market power of the enlarged institution.<sup>9</sup>

To conclude, the empirical evidence on scale and scope is far from conclusive, but - in any event - evidence for scale and scope economies is weak at best. One problem with existing empirical studies - summarised in Table 2 - is that they are quite generic, and often they neither really identify those activities that could offer scope benefits nor do they pinpoint activities (services and products) that generate economies of scale.

#### 2.4 Problems with realising economies of scope and scale

*Weak empirical evidence for scale and scope economies does not necessarily mean that they do not exist, but may be difficult to realise in practice.*

Economies of scope and scale may of course exist, in principle, but are difficult to achieve in practice. This could be for a variety of reasons. To begin with, technological frictions may severely hamper the realisation of potential benefits. For example, a merger between two financial institutions may not readily lead to scale and scope economies because the integration of computer systems may take time. An interesting account on this very issue is the integration of Citicorp and Travelers. A quote from the New York Times (1998) illustrates the issue clearly:

*Citibank and Travelers say their deal is mainly about finding ways to grow rather than cutting costs. But the challenge will be finding common ground between Citicorp's traditional emphasis on advanced technology and Travelers' preference for low-cost, no frills systems.*

<sup>9</sup> In an interesting recent paper, Focarelli *et al.* (2002) contrast the motivation for mergers to that of acquisitions. They conclude, based on Italian data, that mergers often have a strategic, revenue-enhancing objective (cross selling) while acquisitions often aim at improving the credit policy (and thus the loan book quality) of the target.

**Table 2. Selected problems with existing empirical studies on scale and scope economies**

Subject	Issues
<u>Market power analysis: effect on prices and profits</u>	
Static	<ul style="list-style-type: none"> <li>• Is concentration the right measure? What about contestability of markets?</li> </ul>
Dynamic (effect of M&A)	<ul style="list-style-type: none"> <li>• Combined effect of market power and efficiency changes difficult to disentangle:               <ul style="list-style-type: none"> <li>- Profitability ratio affected by market power.</li> <li>- Cost ratio via costs of deposits linked to market power. Operational costs affected by relative importance of deposits versus purchased funds.</li> </ul> </li> <li>• Event studies affected by “signalling”, i.e., the immediate effect of a merger announcement on stock prices incorporates all types of changes in expectations.</li> </ul>
<u>Efficiency consequences</u>	
Static	<ul style="list-style-type: none"> <li>• How to measure scope economies?</li> <li>• Lack of data points for mega institutions.</li> </ul>
Dynamic	<ul style="list-style-type: none"> <li>• Little differentiation between type of mergers and/or type of activities.</li> </ul>

The same article states that Citicorp has a backlog of past integration issues before it can even think of making its systems compatible with those of Travelers. This points at potential frictions that can severely hamper the realisation of scale and scope benefits. Ultimately, the exploitation of benefits of scope might have to include the cross-use of databases from the insurance and banking side. Achieving this might have to wait until IT systems are finally made compatible.

Regulatory constraints may also stand in the way of realising potential scope and scale economies. If regulations force banking and insurance activities to be operated separately, potential scope economies may be hard to attain. This problem was most acute in the United States where up until recently insurance and banking activities could not be combined under one corporate roof. In many other countries, regulations have been less stringent but could still have a major impact on the feasibility of realising scope economies.

*In practice, the realisation of scale and scope economies faces many hurdles, including regulatory, managerial, and political constraints.*

Difficulties in implementing mergers and acquisitions could also turn out to be formidable obstacles to reaping scale and scope economies. For instance, the challenges of staff management in large institutions, especially when they combine different cultures and corporate identities, are notorious. In sum, managerial ability is crucial, but not necessarily on hand, for overcoming such obstacles.

A final barrier worth mentioning are political considerations. Many governments seek to protect their domestic financial institutions; what is more, they may want to create or

preserve “national flagships” to ensure domestic ownership and control. And even if cross-border mergers would occur, a policy favouring “national flagships” would prevent true integration (or rationalisation) of activities. Scale and scope benefits can then not materialise – even if potentially present.

## 2.5 Some conclusions

While the possibility for scope and scale economies is generally present, the distribution network for financial services is a primary source of such economies. For example, the proliferation of saving products and their link to pensions, mutual funds, and life insurance clearly pushes for joint distribution and, thereby, facilitates economies of scope. But even here, a word of caution is warranted. It is true that advancements in information technology have made it possible to better exploit potential scope economies with multiple product offerings to a particular customer group, using new direct distribution channels with relatively easy access to formerly distant customers. But it is also true that modern information technology offers very good possibilities for focused single-product players. Moreover, interfaces may increasingly help bundle the product offerings of specialised providers, thereby becoming a substitute to an integrated provider. Only very well managed financial services firms may realise scope economies. The execution, in other words X-efficiency, is probably more crucial than ever before because single-product players are likely to exploit inefficiencies of integrated financial institutions.

*Only very well-managed institutions may realise scale and scope economies, but company-wide synergy arguments per se do not rationalise universal banking strategies.*

The same arguments apply for vertical disintegration of the value chain. Specialising in one segment of the value chain might for now be too risky a strategy. Banking is too much in turmoil, and specialisation within the value chain may lead to an overly vulnerable dependence on the other players. But ultimately, it does not seem unrealistic to expect the emergence of, for example, product specialists without distribution network (see also McKinsey & Co 2002). This would fit a situation where financial intermediaries become supermarkets that sell products from a variety of suppliers.<sup>10</sup>

Notwithstanding the potential for scope and scale economies, a variety of factors may undermine the possibility for realising scope benefits. This makes it even more important to have well-focused operations and abstain from scope-expanding strategies that would complicate operations. In some cases this also means that one should abstain from broad cross-border acquisitions - unless the specific activity at hand requires this.

Overall, it becomes increasingly questionable to rationalise a universal banking strategy based on some company-wide synergy argument. Scope economies need to be carefully examined and linked directly to specific market segments across clients, products, and geographic areas of operation (see also Smith and Walter 1997). More important for understanding institutions' strive for scope and scale are strategic considerations, a topic that is addressed next.

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10 On the benefits of vertical (dis)integration in the financial services industry there is little empirical work. An interesting exception is a recent paper by Berger *et al.* (2000) who look at profit scope economies in combining life insurance and non-life insurance services in the insurance industry. They find that conglomeration (and hence scope) might be optimal for larger institutions that are primarily retail/consumer focused and have vertically integrated distribution systems.

### 3. Scope as a strategic advantage

#### 3.1 Introduction

The analysis so far has solely focussed on scope and scale economies. But this is inadequate for predicting or explaining the strategic choices of financial institutions. In fact, before reflecting on scope and scale economies, an institution needs to analyse a variety of other factors, notably (i) its core competencies and skills, current strategy, and its financial strength; (ii) alternative scenarios concerning future trends in the market for financial services; and (iii) the market structure emerging under these scenarios, in particular the degree of competition that the institution is likely to face - both in its current market and the market it considers entering.

This implies that scope and scale economies are just one input, albeit an important one, for the positioning today. It is also worth noting that the decision about scale and scope (involving choices about clients, products, and geographic presence) is not final. For example, the choices being made today could seek to keep options open in anticipation of further restructuring once more information becomes available. This is important for interpreting the restructuring that we observe. The current restructuring is motivated by strategic considerations (e.g. positioning) and may not give a good indication about what the future structure of the financial services sector will be. Current decisions might be “posturing” vis-à-vis competitors that might be undone in the future. In this section, I develop this strategic-option explanation for the restructuring in the financial services sector (Section 3.2), and I discuss its relevance in the European context (Section 3.3).

*The current restructuring in the financial services industry is motivated by strategic positioning and may not give a good indication for the future structure of the industry.*

#### 3.2 A strategic-option explanation for the pursuit of scope and scale

The explanation developed in this section is that strategic uncertainty about future exploitable core competencies and skills may dictate broadening of scope. The basic idea is as follows. Suppose a financial institution knows that - perhaps due to deregulation - it can participate in another market at some time in the future. The problem is that this is a new market, so the financial institution is highly uncertain about whether it has the skills to compete effectively in that market.<sup>11</sup> It has two choices. It can wait for some time to find out whether it has the capabilities and core competencies for this new market. Or it can enter the market early and discover what its skills are prior to making costly resource allocation decisions. The advantage of the second approach is that it permits the institution to experiment with a new business and learn whether it has the skills to compete in that business. This learning permits better decisions when competition commences. In particular, having better knowledge about its own skills allows the institution to be more aggressive in its output decisions and gain market share when it knows that its skills are superior to those of its competitors, and to exit the market when its skills are inferior.

One could explain scope expansion as the financial institution reserving the right to play in a variety of new activities. By making incremental investment today, the institution puts itself in a privileged position through the acquisition of superior information by learning. This

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<sup>11</sup> Note that these are strategic investments in activities that are uncertain. What I mean by this is that the investment is in an activity with uncertain profit potential, or that the fit between the new activity and the existing activities is uncertain.

*Strategic positioning takes place against the background of uncertainty about the demand for new financial services and institutions' skills to supply them.*

allows it to wait until the environment becomes less uncertain before determining whether to compete in the new market and, if so, how aggressively. However, whether financial institutions indeed acquire, and exercise, the right to play in a variety of new activities is very likely to depend also on the competitive environment in which they operate - now and in future.

In a recent paper Boot *et al.* (2002) develop a model that formalises these ideas and incorporates scope as a potential competitive advantage. The framework in that paper is as follows. It starts out with a financial services sector with narrowly defined existing activities and asks whether financial institutions should expand into a new activity. A key feature of the setting is that there is uncertainty about at least two issues: first, about the demand for this new activity, i.e. the activity has prospects only in the long run, but demand may not materialise at all; second, uncertainty about the skills needed to exploit the opportunities possibly arising from the new activity. Another feature taken into account is the degree of competition in both existing and new activities. This is the setting in which the institution must decide whether or not to expand in this activity and, if so, whether to enter early or late.

Early entry is costly because the activity becomes important only later, if at all. Entering early requires investments to be made prior to the resolution of demand uncertainty; these investments are largely irreversible, which means that costs are sunk and cannot be recovered if the institution decides later to exit the market. Another potential cost is that scope expansion could reduce the competitiveness of existing operations due to dilution of focus, for example. But early entry also promises benefits. It offers potential strategic advantages. In particular, it could lead to the discovery of skills that would allow for a more efficient delivery of the new activity and, hence, make the financial institution a more credible competitor once the prospects of this activity become clear. It is worth noting that the value of early scope expansion is increasing in the strategic uncertainty about the skills needed for future success in exploiting new opportunities.

Financial institutions faced with these options need to assess whether the benefits of early entry outweigh the costs. Whether the trade-off comes out in favour of early entry essentially depends on two factors. For one thing, uncertainty about skills plays a key role; if they are substantial, early entry may be beneficial. For another, the degree of competition - both in existing and new activities - is a decisive element.

The competitive environment of the existing activities enters the analysis because of the investment and risk associated with early entry in the new activity. If the existing activities face "too much" competition, financial institutions would be unable to absorb the cost of irreversible investment and, thus, the risk associated with early entry in the new activity. In essence, the institution's existing operations must be sufficiently profitable to give it the necessary financial strength - or "deep pocket" - to absorb the potential loss of the capital invested early if there is no demand or if skills turn out to be inadequate. *Ceteris paribus*, deep pockets raise the likelihood of early entry, and early entry into new markets is the more likely, the lower the degree of competition is in existing activities. An immediate implication of all this is that investments in strategic options and thus the adoption of broader, less-focused strategies will be observed in less competitive industries, whereas institutions in competitive industries, will embrace more focused strategies.

In analysing the effect of the anticipated future competitive environment in the new activity on the entry decision, three cases can be distinguished. If the financial institution anticipates

little or no competition in this activity, early entry - with its accompanying cost and dilution of focus - is unnecessary because a competitively unchallenged institution can operate successfully in this market without the benefit of early entry. At the other extreme, if competition anticipated for the new activity is very intense (perhaps due to many potential future competitors), early entry is not an attractive proposition either and is once again sub-optimal. In the intermediate case of moderate anticipated competition, early entry is a promising strategy unless, that is, there is too much competition in the existing activities.

The influence of the competitive environment on the optimal scope of financial institutions is summarised in Table 3. The main finding is that moderate anticipated competition in the new activity together with little-to-moderate competition in existing activities facilitates early entry, thus making the pursuit of scope a promising strategic option. Overall, the analysis suggests that scope expansion is promising when there is high strategic uncertainty, moderate competition expected in the new activity, and low-to-moderate competition in the existing activity.

*The degree of competition in both existing and new activities critically shapes the strategic options that financial institutions pursue.*

**Table 3. Optimal scope as function of the competitive environment**

Anticipated competition in the strategic option, i.e. the <u>new activity</u>	Current competition in existing activities	
	Little to moderate competition	High competition
Little competition	Narrow	Narrow
Medium competition	Broad	Narrow
High competition	Narrow	Narrow

Note: Narrow = no early investment in new activity; broad = early investment in new activity.

The strategic-option explanation offers additional insights. For instance, the benefits of consolidation can be explored. To illustrate this, assume that there are multiple competing institutions and that two of them are contemplating a merger. The question is whether merging today gives them a competitive advantage in undertaking the new activity tomorrow. The answer is affirmative. Merging helps create deep pockets, and possibly also reduces the degree of competition, making investments in strategic options more affordable. It should be clear that these effects have little significance in an environment without strategic uncertainty. The analysis thus predicts greater consolidation in industries with more strategic uncertainty. In this context, it is also worth pointing out that if a scale-expanding merger deepens the institution's pockets, scale expansion will facilitate scope expansion and thus precede it.

Another insight is that there could be an interaction between uncertainty about competencies and skills, on the one hand, and competitive behaviour on the other. To explain this, suppose a specialised provider can offer the new activity that a financial institution considers in a scope-enhancing strategy. Assume further that the specialised provider and the financial institution would form a Cournot duopoly in the new market. In these circumstances, the financial institution would benefit from early entry because it would then learn its skills in the new activity; allowing it to compete more aggressively when it has favourable information about its skills and to behave more cautiously when it has poor

information about its skills. The benefits of early entry also depend on how likely it is that a specialised provider will come along.

Before discussing the relevance of the strategic-option explanation for what is happening in the European financial services sector, it is probably useful to conclude with a few remarks that explain why the strategic-option explanation fits the financial services sector so well. There are at least three reasons. First, deregulation of the sector is opening doors to new activities at a rate that is unprecedented since the Great Depression. Second, the swirling tides of technological and regulatory changes are generating a level of uncertainty about the skills needed to operate successfully in the future that is perhaps greater in the financial services sector than in most other industries. Lastly, banks and to some extent insurers have traditionally faced limited competition in their home markets. This has created deep pockets across the industry, and serves to support the broad strategies observed particularly in banking. The combined validity of these arguments makes the model especially suited for the financial services industry.

The precise interpretation of the model of strategic uncertainty could be amended to fit financial institutions even better. In particular, one could interpret the institution's problem as one of not knowing what combination of activities will give it a competitive edge in future. In this interpretation, a financial institution is not contemplating to embark on entirely new activities (as assumed above) but on activities that it traditionally chose to abstain from. Choosing a wider set of activities would let the institution discover what activities optimally fit together.

### 3.3 Relevance of strategic options in the European context

*A comparatively low degree of competition in a number of EU countries could explain why many financial institutions pursue scope-enhancing strategies.*

A key message of the strategic-option explanation is that investments in strategic options and thus the adoption of broader, less-focused strategies will be observed in less competitive industries, whereas institutions in competitive industries will embrace more focused strategies. This could explain why Continental European financial institutions generally follow broad strategies. Their local market power allows them to afford the widening-of-scope strategy and benefit from its potential future strategic advantages. Indeed, industry practitioners are convinced that a strong position in the home market is crucial for a successful expansion in foreign markets. Generally, this seems to be the case, as a few examples from banking illustrate. Belgian banks generally have weak foreign operations. One reason is that the Belgian political situation (the split between the French and Dutch speaking regions) did not allow for strong domestic powerhouses. Swedish and other Scandinavian banks suffered from a financial crisis in the late 1980s and early 1990s, inhibiting their foreign aspirations. By contrast, the Dutch, Swiss and - to a lesser extent - French powerhouses have strong franchises in their home markets and all have foreign aspirations. Furthermore, multiple mergers in the Spanish banking sector, for instance, rapidly led to two big banks, BBVA and BSCH<sup>12</sup>. Their foreign aspirations have largely been limited to the South American market, but by now (and after running into problems in South America) also involve other Southern European countries.<sup>13</sup>

<sup>12</sup> Banco Bilbao Vizcaya Argentaria and Banco Santander Central Hispano, respectively.

<sup>13</sup> The German banks face difficulties in their home market. Across the Channel, Hongkong and Shanghai Banking Corporation Ltd (HSBC) and Royal Bank of Scotland (RBS), have strong positions in their home markets, and seek focused international expansion.



In the interpretation of the model sketched above, strength in the home markets allows financial institutions to invest in strategic options. An important one is investment banking. While Continental European banks traditionally dominated the domestic activity in investment banking, they have had a more marginal role in investment banking in foreign markets and now also face severe competition in their domestic investment banking activity. Many of them feel that a presence in investment banking might be important for their existence as powerful banks in the future. They are willing to accept - for the moment at least - relatively low returns on those activities. The potential but uncertain vital role of these activities in the future defines them as a strategic option.

From a shareholder-value-maximisation point of view, investing in strategic options might be desirable (if at least potentially sufficiently lucrative). However, how can we distinguish a management that is pursuing value-maximising strategic options from one that simply reflect managerial entrenchment? That is, managers (and governments!) may just want powerful institutions for their own sake. Distinguishing between those explanations is difficult. The experiences of the (no longer independent) French bank Crédit Lyonnais teach us: banks that are not accountable and, even worse, operate as playground for government-appointed cronies, are unlikely to follow value-maximising strategies; growth then becomes a managerial entrenchment strategy.

*In practice, scope-enhancing strategies that aim at value-maximisation are difficult to distinguish from those that reflect managerial entrenchment.*

Banks themselves are ambivalent too. The struggle of European banks in investment banking is a perfect example: while some see it as a strategic option, others (NatWest - now RBS - and Barclays) have retreated. And then, the recent partial retreat of ING from investment banking and the problems that Dresdner Bank faces with investment banking under the umbrella of Allianz indicate banks' undecided approach. While investment banking might be a valuable strategic option, lack of profitability, deep pockets, and/or core competencies may dictate a retreat. Obviously, opinions may also differ on the viability and importance of investment banking as a strategic option. Not more than a year ago, many analysts argued that the lending capacity of commercial banks could give them a competitive edge in the investment banking market. More recently, particularly in light of the high losses on telecom-related debt incurred by some of these players, synergies between commercial and investment banking look much less convincing.

There is a similar ambivalence vis-à-vis the bank-insurance model. Some institutions think that insurance is perfectly complementary to commercial banking (e.g. to economise on the distribution network) and have embraced it; examples included ING and Credit Suisse/Winterthur. Others, such as AEGON - one of the world's largest life insurance groups, have rejected it. Apparently, market players differ in their assessment of the viability and importance of insurance activity as a strategic option. But here, at least in terms of distributing financial services to targeted customer segments, some agreement exists on the complementarity and synergies between commercial banking and insurance. The strategic consideration might be a different one, however. For example, AEGON is probably of the view that its possibilities for taking part in the ongoing consolidation in the insurance industry would be hampered by linking up to a banking institution now. After the consolidation phase is over, it may actually subscribe to the bank-insurance model. However, it may also believe that more focus and alliances/joint ventures are superior.

Nevertheless, I do believe that scale and scope economies are present in the European financial services sector. But I also observe that much of the consolidation in the sector is

defensive. Consolidation has increased scale and scope mainly in domestic markets and facilitated local market power. Size has reached a level that seriously questions whether any benefits of scale remain untapped. At the same time, one wonders whether the wider scope is truly sustainable and whether it will not cause dilution and loss of focus. If so, it will clearly limit the desirability of investing in strategic options. Instructive in this respect is that the operations of European financial institutions in foreign markets, where they face more competition, are generally well focused.

### 3.6 Summary

Strategic considerations play an important role in the restructuring of the financial services industry. The arguments developed above help to give a prescription about where scope and, to some extent, scale become important from a strategic perspective. The decisive factor is strategic uncertainty, with the degree of competition a crucial complementary factor.

The development of alternative distribution channels (e.g. the Internet) is a primary source of strategic uncertainty. Moreover, while developments in information technologies have substantially enhanced the feasibility of managing larger organisations, it has induced uncertainty about the desirable scale and scope of operations. Overall, strategic uncertainty suggests that, for the moment, bigger and broader seems to be the safest option.

However, the degree of competition also plays an important role. In particular, too much competition in existing activities weakens the rationale for scope expansion. By extension, the fairly protected position of institutions in their home markets has allowed them to choose a broad positioning. As markets become more open, both to foreign competitors and inter-sector entry, this choice will be reconsidered. In fact, there are indications that this phase has started, making more focus inevitable before not too long. This takes us to a brief outlook for Europe's financial services industry.

## 4. Outlook - Europe's financial services industry in a state of flux

*The strategic-option explanation implies that financial institutions are likely to pursue different strategies, which may be reconsidered in future.*

The analysis of the preceding section helps understand current trends in consolidation in Europe's financial services industry. A key implication is that financial institutions are very likely to pursue different strategies and may have good reasons for reconsidering current strategies in the future. Against this background, this section briefly discusses alternatives to consolidation and, more generally, considers political obstacles to rationalising the structure of Europe's financial services industry.

A potentially important alternative to consolidation is building alliances. The concept of alliances is underdeveloped in banking. This is to some extent surprising, as banks have engaged - for instance - in correspondent banking, particularly in the context of cross-border payment services. But correspondent banking is losing its importance. In particular, with advances in information technology, international payment and settlement systems have become available (e.g. the emergence of TARGET and settlement systems like Cedel and Euroclear). These developments reduce the need for corresponding banking. More importantly, correspondent banks may have become competitors in areas where they

were cooperating before. For example, some banks seek to gain a competitive edge by offering proprietary cross-border payment facilities. This points at an important consideration for the feasibility of correspondent banking, or alliances for that matter. It only works if the interests of the participating institutions are sufficiently aligned.<sup>14</sup> But why may alliances become important?

A fundamental reason is that vertical disintegration in the value chain will gain in importance (see also Berlin 2001). This may enable greater specialisation and, thus, focus as well as economies of scale. Alliances could play an important role in this process. They may introduce more durable, yet flexible cooperative structures, facilitating interactions between the different parties in the value chain. An example is the opening up of a bank's distribution network to products from other banks. In that way, institutions could exploit their local presence by capitalising on their distribution network; simultaneously, product specialists may emerge that feed products into these distribution networks.

*Alliances and joint ventures could introduce more durable yet flexible cooperative structures.*

The applicability of this idea is broader. Financial institutions rooted in strong local relationships may gain access to more distant asset management services that are scale-intensive and globally, rather than locally oriented. It may well be possible to offer some of these services in an alliance (i.e. to join forces) and still capitalise on customer-related synergies. While it can be argued that a merger with these institutions allows for a smoother operation of these services, one can take issue with this point of view.

First, for several reasons, cross-border mergers may not (yet) be feasible. A focused alliance would create valuable linkages between institutions with immediate synergy benefits, but could also allow nationally-rooted partners to get to know each other. In that sense, it would be an intermediate phase. As a second argument, using alliances for asset management and/or specific investment banking activities may, if properly designed, combine the benefits of an integrated universal banking structure with a stand-alone type of organisation of those activities. For example, all alliance partners would have a limited exposure to these activities, which helps them maintain focus. In particular, cultural conflicts and distractions associated with trying to build up (or buy) an investment bank next to running the relationship-rooted regional bank are prevented.<sup>15</sup> Obviously, the alliance model does not come without cost. The important task is to define a clearly defined portfolio of activities that would become part of the alliance. This will not be investment banking in the broadest sense of the word. Similarly, in the case of asset management, the alliance partners would each maintain their own proprietary access to the customers, but join forces in the asset management operations including research and back office activities. This would facilitate the information technology investments that allow the partners to capitalise on scale economies. Maintaining proprietary access by the individual alliance partners preserves customer-related scope economies.

The same arguments could be made for bank-insurance combinations. That is, banks could choose to engage in an alliance with an insurer rather than merge. The alliance model is

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<sup>14</sup> It is worth noting that correspondent banks could traditionally not enter each other's markets. Interests were therefore more readily aligned.

<sup>15</sup> The experience of some banks is that top management gets fully distracted by the investment banking activities and spends disproportionately little time on the often more profitable non-investment banking activities.

*Alliances and joint ventures are alternatives to consolidation that are likely to become more important in the period ahead.*

indeed observed (e.g. Credit Suisse and Winterthur before they merged). It is possible to distribute insurance products via a bank's distribution network based on a license agreement.<sup>16</sup> However, at least until recently, the perception in the market was that the integration of information technology services is only assured with an outright merger. If true, the desired synergy in distribution (and also the complementary feeding of asset management operations) would then seem to favour mergers.

A key question is whether this will remain so. I tend to believe that joint ventures and alliances will gain importance in the future, in particular as and when uncertainties surrounding the industry wane. At present, vertical disintegration could create an unpredictable dependence on other parties in the value chain. Ultimately, alliances seem only feasible if the activities that are part of it can be run as a more or less separate (jointly-owned) business unit with considerable independence from the parent institutions. This is for now most likely for smaller regionally specialised financial institutions that may want to join forces in, for example, investment banking and asset management. For bigger institutions alliances are for now less relevant, but when these institutions will finally choose to focus, alliances are likely to grow rapidly.

The pros and cons of consolidation and alliances apart, political obstacles may slow down the move towards a more rational structure of Europe's financial services industry. While EU banking directives aim at liberating cross-border banking, domestic banks are being considered national flagships that governments - some more, others less - are trying to protect. This reflects a fundamental belief that foreigners should not control domestic financial institutions, which has - so far - almost prevented any cross-border merger.

Even in countries, such as the Netherlands, where governments do not directly interfere in banking and where banks are considered truly commercial enterprises, the political dimension is important. Central banks, ministries of finance, and the banks operate in close concert. This is not surprising: a very homogeneous group of executives is in charge of the financial sector, the central bank and government ministries, guaranteeing a clear national identity of domestic institutions. In countries with explicit government involvement (e.g. Germany, France and Italy), foreign control over domestic institutions is even less likely unless banks become so inefficient and weak that involvement of foreign investors is seen as inevitable to fix the problem. But in general, the primary response to the liberating EU directives has been defensive: domestic mergers are encouraged to protect alleged national interests. A case in point is Germany, where banking is surprisingly dispersed despite the (traditionally!) powerful images of Deutsche Bank, Commerzbank, and Dresdner Bank (now part of Allianz). Public policy definitely aims at protecting the interests of these institutions, and consolidation occurs mainly at the level of the *Länder*. Indeed, the political dimension is especially relevant at this level, which explains why the German banking sector has seen regional and not national consolidation.

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<sup>16</sup> Very recently, ABN AMRO announced that it would put its (limited) insurance operations in a joint venture with Delta Lloyd (a bank-insurer). It hopes that the alliance will promote a more effective cross selling of insurance products via its own distribution networks.

Overall, the national flagship dimension has been of primary importance in Europe.<sup>17</sup> As a result, cross-border expansion is rare, and consolidation is primarily observed within national borders. That said, it remains an open question whether national (European) authorities are serving the interests of their constituencies when advocating national flagships. This is an intriguing question that needs to be looked at in a game-theoretic context. If other countries support national flagships, an individual country may be well-advised to follow the same policy. However, all would possibly be better off if none pursued a national flagship policy.

To conclude, powerful forces are driving consolidation. Value-maximising behaviour is one of them, but the political dimension cannot be ignored. Value-maximising behaviour, in turn, comprises two main elements: the search for scope and scale economies as well as strategic positioning in an uncertain and rapidly changing environment. Strategic positioning has created broad powerhouses. But this will change. Competitive pressures will force financial institutions to discover their true competitive advantages and choose an optimal configuration of services and activities. As a result, the new demarcations between the financial institutions may be very different from the past, but it is very unlikely that a single strategy will dominate the industry. The regional expansion that characterises much of the merger wave in the United States will carry over to Europe. Cross-border acquisitions are coming, particularly with the arrival of the European Monetary Union, which is a catalyst that will accelerate the integration of national financial markets, inducing a more pan-European view on financial services. Overall, the process of restructuring will be a fascinating one, and the current developments are just an interesting start.

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17 In this context, a comparison to the United States is worth making. In the United States, interstate expansion has been a driving force behind the consolidation in the banking sector. Politics do not seem to interfere any longer with interstate expansion. However, the political dimension seems to have an effect on the demarcations between commercial banking, investment banking, and insurance. Powerful lobbies are successful in mobilising (local) politicians, and they had been able to obstruct major banking reform in the US Congress until the passing of the Gramm-Leach Bliley Act of 1999. In other words, in both the United States and Europe vested interests are at work. In Europe, national authorities are preserving national flagships; in the United States, powerful lobbies seek to preserve traditional demarcations between financial institutions.

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