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EUROPEAN BANKS' GROWTH STRATEGIES

Gregorio De Felice - Debora Revoltella

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1. INTRODUCTION*

The creation of European Monetary Union, the abolition of the last non-tariff barriers (which were partly responsible for protecting national banking systems from international competition even after the creation of the single market), and finally, the emergence of new distribution channels like telephone and online banking, have led to an acceleration in the process of financial system integration, and to radical changes in the structure of the banking industry in Europe.

In this context, the most evident and widespread trends seen in the sector are the external growth of banking institutions and a sharp increase in M&A activity in the sector. Some five of the biggest European banking groups have been created over the last two years[1], and if the merger between the two largest German banks had taken place, it would have created in the same period the biggest bank in the world in terms of total assets[2].

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1 *We refer to the mergers between Banque National de Paris and Paribas in France, between Nat West and Royal Bank of Scotland in the UK, and between Banca Intesa and Banca Commerciale Italiana in Italy, and the creation of Banco Santander Central Hispano (BSCH) and Banco Bilbao Vizcaya Argentaria (BBVA) in Spain.*

2 *We refer to the failed merger between Deutsche Bank and Dresdner Bank, and subsequently between the latter and Commerzbank. Germany's third-largest bank, Dresdner Bank, resolved its situation only recently with the announcement of a merger with the insurance group Allianz.*

There are many reasons behind the banks' decision to pursue a strategy of external growth.

First, many of these M&A operations were launched with the aim of increasing market share and achieving significant economies of scale. At the beginning of 1999, the European banking market showed clear signs of excess capacity, demonstrated by a high level of banking activity, and at the same time, excessive fragmentation, with the biggest banks having only small market shares. A situation of this nature risked affecting the profitability of single institutions. Moreover, owing to fierce competition in areas such as loans, the banks' contractual power over their customers was very low.

Second, the widespread privatisation of European banks, which began before the introduction of the euro, increased the importance of 'shareholder value', that is, a focus on creating value for the shareholder through the pursuit of profit targets and good stock market performances. In many cases, this was a wholly new outlook in comparison with even the recent past.

Finally, banks' external growth strategies were spurred by the necessity of dealing with technological innovation, which required heavy investment over long periods of time. Overall, the European banks have been working towards greater operational efficiency, through the exploitation of economies of scale and scope, and through the opportunities offered by product diversification strategies. The methods used by banks in implementing their growth strategies are fairly diverse. Expansion on domestic markets through mergers and acquisitions has been accompanied by international growth strategies within and outside the European Union.

This growth, often motivated by a lack of room for expansion on the domestic market and the desire of banks to reposition themselves on the new European market, has encouraged a flurry of cross-holdings and partnerships between major banks. In this context, it is not always easy to see the economic reasons for some of the minority stakes taken in banks in the European Union. In the longer term, over the next five to

ten years, this new shareholding network could in some cases be the prelude to the creation of truly multinational institutions.

The aim of this work is to analyse the external growth strategies of European banks, with particular reference to international expansion. In particular, we will examine the main determinants of cross-border mergers in Europe, in order to evaluate whether the new entity of a 'European bank' is in fact starting to emerge as the result of geographical repositioning strategies in the new single market.

This paper is part of a body of empirical literature which has grown up rapidly over the last few months. The ECB report of December 2000 on M&A operations in the European banking sector[3] was the first attempt to provide a systematic study of bank mergers in the European Union. Moreover, attention has up to now been mainly focused on evaluating the phenomenon in terms of the number of operations, and their institutional and organisational features. The report of Focarelli and Pozzolo[4] analyses the determinants behind cross-border investments by banks in the OECD countries, considering both the decision itself and its geographical focus. In this case too attention is centred on the number of operations and not on their value; a precise evaluation of the international presence and external growth strategies of single banks is therefore lacking. Finally, a recent report by the G10[5] gives an outline of the consolidation process on the main international financial markets, with an in-depth analysis of a number of national companies and overall trends.

This work differs from earlier studies in that it is based on a specially built database, which has enabled us to evaluate foreign direct investment by European banks in

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3 *European Central Bank (2000): "Mergers and acquisitions involving the EU banking industry – facts and implications", ECB Occasional Paper, December.*

4 *Focarelli D. and Pozzolo A.F. (2000): "The determinants of cross-border bank shareholdings: an analysis with bank level data from OECD countries", Temi di discussione Banca d'Italia, n.381, October.*

5 *G10 (2001), Report on consolidation in the financial sector, January, at* www.bis.org

both the EU and the emerging markets not only numerically but also in terms of value (measured as total attributable assets). In this way we have attempted to evaluate the amount of outgoing and incoming investment activity by the various systems and banks, obtaining a measure – up to now not available – of the degree of cross-border integration of the European banking market.

After presenting the main results of our analysis of the growth strategies of EU banks (section 2), we will then attempt to identify the determinants of these strategies (section 3). Our econometric analysis is aimed at identifying the specific characteristics of banking systems which encourage foreign direct investment. In otherwords, we will look at both domestic factors and those relating to the new EU markets entered. Identification of the sector-specific determinants of investment gives us an overall picture of the external growth and international merger strategies of the new single European market. Subsequently, we will analyse the growth strategies of European banks on the emerging markets (section 4), and then try to explain the motives that drive a European bank to expand outside, rather than within the EU (section 5). Finally, we will outline the main conclusions of the study.

2. INTERNAL GROWTH OF EUROPEAN BANKS AND EXPANSION STRATEGIES ON THE EU MARKET: SOME FIGURES

Since 1998, the number of mergers and acquisitions in the eurozone has increased sharply (see table 1). Looking only at domestic operations, we can see that in the two years 1998-1999, the average number of operations rose from around 280 a year to over 400. Cross-border operations, of which there were no more than about 50 a year until 1998, went up significantly in 1999, the year in which the single currency was launched, and showed an even more rapid growth trend in 2000, with 62 operations in the first half of the year alone. These figures appear to show that the growth of European banking systems was first domestic, and shortly afterwards extended overseas. The number of cross-border operations is, however, still much lower than the number on domestic markets.

Table 1 – NUMBER OF DOMESTIC AND CROSS-BORDER M&A OPERATIONS IN THE EUROPEAN UNION

	1995	1996	1997	1998	1999	2000 1st half	1995-2000
Domestic M&A operations	275	293	270	383	414	172	1807
Cross-border M&A operations	51	50	49	51	83	62	346
Total	**326**	**343**	**319**	**434**	**497**	**234**	**2153**

Source: European Central Bank, December 2000.

2.1 Domestic mergers and the degree of national concentration

Almost all the major European banks have participated in mergers and acquisitions over the last few years. In France, Crédit Agricole bought Banque Indosuez in 1997, while the merger between BNP and Paribas in 2000 led to the creation of the second-largest banking group in Europe. In the Netherlands, ABN Amro and ING are the result of M&A operations launched at the beginning of the 1990s, while the three largest banks in Italy – IMI-San Paolo, Unicredito and Banca IntesaBCI – have also been involved in big mergers.

The last two years have been particularly significant also for the Spanish banking system, which has seen the creation of two big national groups: Banco Santander Central Hispano (BSCH) and Banco Bilbao Vizcaya Argentaria (BBVA). In the UK, following the formation of Lloyds TSB in the early 1990s, the process of concentration on the domestic market continued with the proposal of a merger between Barclays and the Woolwich, and between Abbey National and Bank of Scotland. In contrast, and despite their significant size on the European market, the big German banks are still lagging behind in the M&A process. Apart from HypoVereinsbank, created from the merger of two important institutions in 1998, no big German bank has until now managed to carry out its domestic expansion plans.

As the ECB figures show, around 84% of the mergers and acquisitions implemented in the EU banking sector between 1995 and the first half of 2000 were of a domestic nature. As a result, although there are still big differences between systems, banking

concentration increased in all EU countries, as can be seen from table 3, which shows the market share of the biggest five banks in each country.

The countries with the lowest degree of concentration in 1995 were those which showed the greatest dynamism, partly closing the gap against the other countries. In these countries, the number of M&A operations was much higher than the EU average, and often involved smaller banks at first, the larger banks entering the arena only at a later date, with tangible effects on the concentration indicators.

Table 2 – NUMBER OF DOMESTIC M&A OPERATIONS IN THE VARIOUS EUROPEAN BANKING SYSTEMS

	1995	1996	1997	1998	1999	2000 1st half	Total 1995-00
Austria	14	24	27	37	20	5	127
Belgium	6	8	7	6	6	0	33
Denmark	2	2	1	1	0	1	7
Finland	7	6	5	5	2	3	28
France	60	61	46	52	51	21	291
Germany	100	117	109	189	240	91	846
UK	2	4	15	16	14	4	55
Greece	0	0	3	7	3	0	13
Ireland	1	1	0	2	1	0	5
Italy	68	56	45	52	64	30	315
Luxembourg	3	1	3	9	6	6	28
Netherlands	2	2	5	0	1	2	12
Portugal	5	5	1	1	0	6	18
Spain	4	4	1	5	5	3	22
Sweden	1	2	2	1	1	0	7
Total	**275**	**293**	**270**	**383**	**414**	**172**	**1807**

Source: European Central Bank, December 2000.

The degree of concentration of banking systems is greater in the smaller countries, where it is also easy to win market share. Moreover, it is no coincidence that a higher

degree of transnational integration has emerged between groups of smaller countries, like Benelux and the Nordic countries.

Table 3 – CONCENTRATION OF EUROPEAN BANKING SYSTEMS

	Market share of 5 largest banks (1995)	Market share of 5 largest banks (1999)	% variation in degree of concentration (1995-99)	Absolute var. in degree of concentration (1995-99)
Sweden	86.53	88.21	1.94	1.68
Netherlands	76.14	82.25	8.02	6.11
Belgium	51.20	77.39	51.15	26.19
Denmark	72.00	77.00	6.94	5.00
Greece	75.66	76.62	1.27	0.96
Finland	70.62	74.33	5.25	3.71
Portugal	74.00	72.60	-1.89	-1.40
Spain	47.30	51.90	9.72	-4.60
Austria	39.19	50.39	28.58	11.20
Italy	32.36	48.33	49.35	15.97
France	41.30	42.70	3.38	1.40
Ireland	44.40	40.79	-8.13	-3.61
UK	28.27	29.07	2.83	0.80
Luxembourg	21.23	26.09	22.89	4.86
Germany	16.67	18.95	13.68	2.28

Source: European Central Bank, December 2000. Values refer to total assets.

Overall, although both EU and national[6] competition rules leave plenty of room for discretion in their application, and mergers between big banks are judged on a case-

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6 *Responsibility for maintaining competition on the banking market following mergers is generally national. However, if a merger is European-level (that is, if it exceeds a certain size), the European Commission is the only body which may set the criteria for its implementation. In this situation, any single state may not apply national criteria, although in some cases, a country may use a right of veto in order to protect public safety or other specific interests. In general, if the Commission prohibits a merger, then the national authority may not act against this ruling. However, the reverse is possible: that is, a national government may give authorisation for an operation which is then blocked by the EU. A case has also arisen in the past whereby a merger blocked by a national authority has then been approved following intervention by the European Court. The EU analyses such operations on a case-by-case basis. Once the relevant market has been defined in*

by-case basis, the figures show that domestic concentration on some markets has already reached very high levels. In the Nordic countries, Belgium, the Netherlands, Greece and Portugal, values of above 70%, and in some cases 80%, indicate that no further domestic mergers are possible, at least between the biggest banks. In the other countries, where concentration indicators stand at 40-50%, the attitude of the authorities appears to be one of aversion to further domestic operations. There is still significant room for domestic growth in Germany, where the degree of concentration is still the lowest of all 15 EU countries, with the biggest five banks jointly holding a market share of less than 20%.

2.2 Cross-border operations within the EU

The above figures show how acquisition strategies on domestic markets have been the main growth driver for European banks. However, as we will see in this section, significant cross-border activity has also begun to be observed.

For a better understanding of cross-border growth strategies, we have used a specially built database, which collects together information on direct investment by

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terms of product and geography, various competitiveness indicators are then evaluated. Gerenally speaking, deposits and customer loans are considered nationally, while financial services are evaluated at a international level. As a general rule, if the market share of the new institution is below 15%, then the situation is not considered risky, whereas if it is above 30%, the situation is studied very carefully. It should however be noted that assessment of single cases is made on the basis of many factors, and there is plenty of room for discretion. Regulations in single states are generally more detailed, and the geographical market is often considered at a regional or provincial level. In Italy, for example, the deposits market is considered provincially, while loans are considered regionally. Italian law too leaves plenty of room for discretion and a case-by-case assessment of single operations, although the general rule states that a merger is not considered to be a risk to competition if the market share is below 15%, unless there are other causes for concern. For a more detailed analysis, see Polo (2000).

each EU bank in other EU countries. Direct investment means any bank based in the EU which is acquired (directly controlled) by another EU bank.

In accordance with standard procedure, the value of the investment has been measured in terms of total attributable assets; that is, by multiplying the percentage shareholding under foreign control by the total assets of the bank acquired[7].

An examination of foreign direct investment flows in the EU banking sector by EU banks (table 4) shows that Germany is the country involved in the most cross-border activity, although more than 50% of investments consist of direct asset management subsidiaries in Ireland and Luxembourg. The interest of German banks in cross-border strategies within the EU was highlighted by the recent acquisition of Bank Austria by HypoVereinsbank.

Austria is the only country to see a clear contraction in cross-border investment in the EU, owing to the new strategy of its banks aimed at expanding in central and eastern Europe.

Particularly international in outlook are the smaller countries, mainly the Nordic countries, Belgium and the Netherlands. We can define the market as highly integrated in these two groups of countries, thanks partly to the presence of important cross-border banks like Merita Nordbanken[8] and Banque Fortis.

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7 *The shareholdings for each year are updated according to the information available in December, while total assets are those available in December; that is, those from the previous year.*

8 *Merita Nordbanken was created in 1997 from the merger of the largest Finnish bank with the largest Swedish bank. In both countries the concentration of the domestic market is very high, at 70.6% in Finland and 86.5% in Sweden. Merita Nordbanken is the second-largest bank in the Nordic countries.*

Table 4 - CROSS-BORDER INVESTMENT BY EUROPEAN BANKS IN EU BANKING SYSTEMS BY INVESTING COUNTRY (figures in billion euro)

	1996	1997	1998	1999	2000	Average FDI/TA1996-2000	FDI/TA 2000(*)
Austria	4.5	2.9	1.9	2.0	2.0	1.1%	0.7%
Belgium	23.8	57.5	67.1	78.2	182.3	21.0%	24.0%
Denmark	4.4	4.9	8.1	9.1	14.5	17.5%	7.1%
Finland	0.7	0.7	0.7	41.6	44.8	14.4%	30.3%
France	96.9	171.8	186.3	210.2	185.7	17.9%	7.0%
Germany	196.6	270.8	310.0	363.4	555.7	12.7%	15.1%
UK	45.1	51.8	52.1	51.1	138.9	4.5%	7.3%
Greece	0.0	0.0	1.2	1.0	1.1	0.6%	0.9%
Ireland	6.6	1.6	21.8	31.5	29.7	10.3%	11.5%
Italy	54.5	57.6	100.6	76.5	132.6	7.6%	9.0%
Luxembourg	0.0	0.0	0.0	0.0	14.2	0.6%	3.0%
Netherlands	25.5	28.4	135.2	226.6	222.3	15.1%	21.6%
Portugal	0.0	0.0	0.0	0.0	5.9	0.5%	2.6%
Spain	24.5	33.7	33.5	76.9	112.3	6.0%	10.7%
Sweden	1.3	2.2	4.0	66.3	116.8	11.3%	32.5%

Source: own estimates based on Bankscope data.

FDI/TA: weight of foreign bank investment in the country on total national assets.

(*) For reasons of homogeneity with the numerator, the total assets of each banking system is calculated as the sum of the total assets of single banks in the various countries as available in December of each year. Despite some differences caused by differing definition criteria, the figures are in line with those released by each country for their monetary and financial institutions.

Incoming investment can be evaluated by comparing the level of FDI in the various national banking systems from other EU countries[9]. If we consider the size of foreign direct investment in relation to the size of the market, we can observe a strong

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9 *The numerator is the sum of total assets belonging to foreign investors in the system, while the denominator is the total assets in the system, calculated from the sum of the assets for each bank in December of each year, as provided by Bankscope. Despite some differences caused by differing definition criteria, the total asset figures are in line with those released by each country for their monetary and financial institutions.*

interest in countries like Luxembourg, Ireland, Finland and Austria (after the acquisition of Bank Austria). All these countries show values of over 40%, highlighting the strong attraction they exert on other banking systems in the European Union. The reasons for this appeal are most likely to do with fiscal advantages and banking secrecy.

In contrast, the weight of foreign investment on total assets in the bigger countries is much lower. The figure stands at around 11% in France, 9% in Italy, 7% in Germany and 6%, while in the UK the weight of FDI is just 2%.[10].

Table 5 – CROSS-BORDER INVESTMENT BY EUROPEAN BANKS IN EU BANKING SYSTEMS BY RECEIVING COUNTRY (figures in billion euro)

	1996	1997	1998	1999	2000	Average FDI/TA 1996-2000	FDI/TA 2000
Austria	30.8	32.6	34.8	39.9	119.8	19.6%	40%
Belgium	48.8	106.4	199.4	187.0	206.5	29.7%	27%
Denmark	0.0	0.8	5.2	5.7	5.7	1.9%	3%
Finland	0.1	0.5	0.6	63.1	67.9	19.6%	46%
France	46.4	81.3	87.3	135.9	291.1	5.6%	11%
Germany	46.4	69.1	80.5	163.5	240.6	4.2%	7%
UK	10.1	7.2	29.8	37.9	41.5	1.6%	2%
Greece	0.0	0.0	0.0	0.0	17.3	2.7%	13%
Ireland	14.8	29.4	44.3	56.2	88.2	28.1%	34%
Italy	31.5	73.7	86.8	137.5	125.2	7.9%	9%
Luxembourg	188.1	215.1	282.7	277.9	361.2	66.6%	76%
Netherlands	18.8	20.3	21.5	34.1	45.2	3.5%	4%
Portugal	18.3	15.0	15.2	14.6	33.2	9.7%	15%
Spain	29.4	31.0	30.4	36.4	65.9	4.3%	6%
Sweden	0.7	1.8	3.8	44.7	49.6	6.1%	14%

Source: own estimates based on Bankscope data.

FDI/TA: weight of foreign investment in banks in the country on total national assets.

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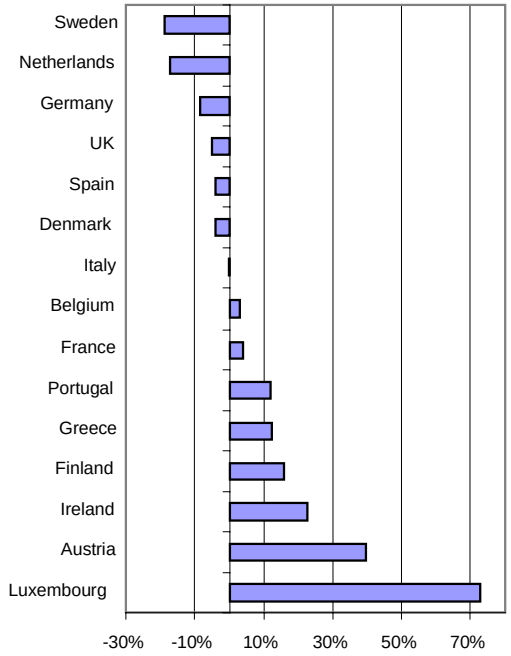
10 *Although London is the main financial centre, many EU banks operate in the UK through their own branches or offices, and do not have large stakes in local banks. This implies that the UK market is significantly closed to FDI.*

A comparison between the level of active and passive internationalisation of the various banking systems (graph 1) appears to show a number of different patterns. While countries like Sweden and the Netherlands are net investors in the area, and Austria, Luxembourg and Ireland are net receivers of investment, France, Italy and Germany have adopted a strategy of balanced internationalisation for their incoming and outgoing investment (especially so when the direct subsidiaries in Ireland and Luxembourg are excluded).

Graph 1 – NET LEVEL OF INTERNATIONALISATION OF EU BANKING SYSTEMS (INCOMING INVESTMENT MINUS OUTGOING INVESTMENT) – year 2000



Source: own estimates based on Bankscope data.

In general, we can observe that cross-border integration between European banks is still weak, although significant signs of change are beginning to emerge. Although

cross-border acquisitions are still limited in number, it is common for the big EU banks to take non-controlling stakes in their foreign counterparts, a move which should be considered as a first prudent step towards European integration. Partnerships and new forms of co-operation are emerging which could be the prelude to future mergers.

An analysis of the EU-wide expansion strategies adopted by the biggest European banking groups, in order of total assets (table 6), shows that ING and BSCH have a strong presence in the EU market, with FDI/total assets ratios of over 35% and 25% respectively. In absolute terms, the three biggest investors are ING, Deutsche Bank and HypoVereinsbank, with investments of over €100 bn in EU countries other than their own.

More than 50% of cross-border investment is concentrated among the biggest banks, whereas small and medium-sized institutions tend to focus on the domestic market. Despite this concentration of investment, the presence of the biggest banks on the EU market still appears limited – the average weight of activity of the Union's 15 largest banks on the European market is 11%, highlighting the fact that the main arena for each bank is still the domestic market.

Many studies have shown that cost savings achievable from domestic mergers and acquisitions are around double those from cross-border operations. This is especially true in the area of retail banking, while overseas operations offer more advantages in investment banking activities, as many of these can be centralised without reference to a bank's domestic base.

We believe there are significant signs that the situation is starting to change, although slowly. As mentioned previously, concentration on many national markets has now reached very high levels, whereas there appears to be considerable room for the biggest banks to grow in the EU as a whole. Overall concentration on the EU market is not yet very high, especially in relative terms. The market share of the five

biggest banks, measured against the total assets of the whole system[11] stood at 17% in 1999 (from 12.5% in 1997), compared with around 30% in the United States and 35% in Japan. Given European banks' interest in gaining a better market position and greater relative size, we can assume that there will be an increase in cross-border mergers and acquisitions over the next few years.

Table 6 – CROSS-BORDER INVESTMENTS BY THE LARGEST EU BANKS (in billion euro) – year 2000

Bank	Country	FDI EU	Total assets	FDI/TA
Deutsche Bank	Germany	106.8	805.5	13.3%
BNP Paribas	France	7.0	698.5	1.0%
HypoVer+Bank Austria	Germany-Austria	100.4	622.5	16.1%
HSBC	UK	81.1	557.2	14.6%
ING Group	Netherlands	174.5	492.8	35.4%
ABN Amro	Netherlands	28.6	457.9	6.2%
Crédit Agricole	France	47.7	439.5	10.8%
Société Générale	France	14.2	406.5	3.5%
Fortis	Belgium	22.3	401.2	5.6%
Barclays	UK	8.0	397.0	2.0%
Dresdner Bank	Germany	58.3	396.1	14.7%
WestLB	Germany	38.4	384.5	10.0%
Commerzbank	Germany	48.8	369.4	13.2%
IntesaBCI	Italy	34.8	302.8	11.5% (*)
NatWest	UK	1.9	285.5	0.7%
Rabobank Group	Netherlands	18.7	281.2	6.7%
Bayerische LandGiroz	Germany	25.6	268.2	9.6%
Abbey National	UK	0.0	262.7	0.0%
BSCH	Spain	64.6	255.0	25.4%

Source: own estimates based on Bankscope data.

(*) Figures net of Sudameris, which is under French jurisdiction but operates almost entirely outside the EU. Including Sudameris, the percentage of total assets stands at 16%.

FDI EU: the investment of each bank in other EU countries, (1999 total assets and year 2000 ownership). TA: last available balance sheet in December(1999 data). FDI/TA: weight of each bank's operations in other EU countries.

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11 *To calculate the total assets of the system we have used ECB aggregates and added them to the total assets of non-EMU countries as calculated by Bankscope.*

3. DETERMINANTS OF CROSS-BORDER INVESTMENTS BY EU BANKS: AN EMPIRICAL ANALYSIS

For a better understanding of internationalisation trends in the various European banking systems, we have carried out an empirical analysis to identify the main determinants of cross-border bank investment. We have made the analysis using a specially built database, which has been aggregated by country, and have explained the inter-relation between each pair of EU countries in terms of direct banking investment by a series of variables, which can be reclassified as country-specific or banking sector-specific variables.

The method used is a well-established one. Several works have analysed the determinants of direct investment in the banking sector over the last few years. Goldberg and Johnson (1990), Urascki and Vertinsky (1992) and Focarelli and Pozzolo (2000) among others, examined the investment decisions of western banks, while Claessens and others (2000) and Papi and Revoltella (2000) focused on banks in emerging markets. In this paper we have paid particular attention to the sectoral factors which encourage the internationalisation process of banks in the EU. In particular, we will look at which features of the system trigger active investment by banks in other EU countries, and which features help to attract the attention of investors. The analysis is aimed at understanding future integration trends on the single European market.

We have carried out our analysis on panel data for the period 1995 to 2000. Table 7 refers only to 2000, and shows the inter-relation between the various banking systems. We can see that the biggest investment flows are from German banks into Luxembourg, while regional integration among the Nordic countries and in Benelux can be clearly seen. In our estimates, we have also excluded foreign investment in Luxembourg from the sample in order to cancel out the distortion arising from the peculiarities of that country's banking system[12].

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12 *Note that investment in Luxembourg represents over 20% of cross-border investment in the EU.*

Table 7 – CROSS-BORDER INVESTMENTS IN THE EU (billion euro) year 2000

ACROSS: INVESTING COUNTRY; DOWN: RECEIVING COUNTRY

	AU	BE	DK	FIN	FR	GER	GRE	IRE	IT	LUX	NE	PT	SP	SW	UK	Total
AU						2.0										2.0
BE	1.2				75.5	16.4		5.2	4.3	59.1	19.3	1.2				182.2
DK										12.5				2.0		14.5
FIN														44.8		44.8
FR	1.6	67.5				20.6			51.2	32.0		3.1	6.8		2.8	185.6
GER	111.1	9.3			57.9		1.2	54.3	44.6	225.7	25.9	1.6	18.6		5.3	555.5
GRE					1.1											1.1
IRE															29.7	29.7
IT	4.8	3.0			36.0	32.6		2.9		29.5		6.9	15.1		2.2	133.0
LUX								2.5				7.5	4.2			14.2
NE		124.5			10.3	65.1		16.8	1.6	2.8				1.0		222.1
PT					0.3								5.6			5.9
SP		2.2			33.1	41.6			22.9			11.1			1.3	112.2
SW	1.0		0.6	67.9		47.2										1167
UK			5.0		77.0	15.0	16.1	6.4	0.4			1.7	15.6	1.7		138.9
Tot	119.7	206.5	5.6	67.9	291.2	240.5	17.3	88.1	125.0	361.6	45.2	33.1	65.9	49.5	41.3	1.758.4
in % Tot	6.8	11.7	0.3	3.9	16.5	13.7	1.0	5.0	7.1	20.6	2.6	1.9	3.7	2.8	2.4	100.0

Source: own estimates based on Bankscope data.

The equation (BANKFDI) estimated is:

$$BANKFDI_{it} = f(SB_F, SB_H, P_H, REL_{F,H})_{it}$$

where SB_F represents the sector-specific variables of the investing country, SB_H represents the sector-specific variables of the receiving country, P_H is the country-specific variables of the receiving country and $REL_{F,H}$ measures the trade between the two countries. Direct investments have been relativized according to the size of the banking system, so that the dependent variable is a measure of the relative presence of the investing country.

We have used the rate of real GDP growth in t+1 (gg) as a country-specific variable for the receiving country[13]. The variable logexpi shows the commercial presence of the investing country in the receiving country, and is a measure of the trade flows between the two countries. This variable shows the traditional part of foreign direct banking investment; that is, the relevance of "follow the client" attitudes.

To take account of the specific nature of the banking sector of the receiving country, we have used three variables: ROEH, CTIH and DIMH. ROEH is a measure of the average profitability of the system, while CTIH indicates the ratio between operating costs and total operating income, and is a rough indicator of the efficiency of the system. If direct bank investment is motivated by the desire to exploit the potential offered by new markets, then banks should invest in countries where the banks are profitable, but less so than in the originating country, in order to gain a competitive advantage over local market players. DIMH measures the relative size of the system against the whole of the EU market. We have then considered a variable dFIL, which is a structural indicator given by the difference in the number of bank branches per 1,000 people in the two countries, and gives an idea of the level of banking activity on the local market (in terms of traditional retail networks)[14].

Then we have used the variable N5F, which is an indicator of the concentration of the banking sector in the investing country, measured as the market share of the biggest five banks in terms of total assets. This is a crucial variable in our analysis, as it is a measure of the fact that it is the banks with little growth potential in their own country which are most active on the EU market. We have then considered the variable NIMF, which measures the average interest margin in the banking system of the investing country. It is also an indicator of the profitability of traditional banking activity on the domestic system.

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13 *Here we have used forecasts from the Economist Intelligence Unit.*

14 *The sectoral variables have been calculated from Bankscope data, with the exception of the variables dFIL and N5F, which have been taken from the ECB (2000).*

We have drawn up a one-way random effect model. The Hausman test confirms the choice of a random-effect rather than a fixed-effect model, as well as its correct definition. The coefficients thus estimated are in line with our forecasts. We have also carried out checks to evaluate robustness of our estimates by adding and taking away some of the variables, which leads to no significant variations in the results.

Table 8 – DETERMINANTS OF CROSS-BORDER INVESTMENTS IN THE EU

BANKFDI	Coefficient	Std. Err.	z	P>z
gg	0.0010	0.0014	0.71	0.48
logexpi	0.0048	0.0021	2.26	0.02
ROEH	0.0012	0.0005	2.30	0.02
CTIH	0.0010	0.0005	2.14	0.03
DIMH	-0.0001	0.0004	-0.29	0.77
dFIL	0.0039	0.1005	0.37	0.71
N5F	0.0003	0.0001	2.54	0.01
NIMF	-0.0101	0.0033	-3.11	0.00
cons	-0.1049	0.0392	-2.67	0.00

Breusch and Pagan test for random effects: Test Var(u)=0, chi2(1)=88.87, P>chi2=0.000 Hausman specification test: Test: diff coeff not systematic: chi2(8)=10.40, P>chi2=0.2378

In general, we can see the importance of trade relations between two countries in explaining their investment choices, which highlights the continued application of 'follow the client' strategies by banks, and therefore the existence of a kind of traditional channel for banks' internationalisation policies.

In our study, in contrast with others, the economic growth prospects of the receiving country are not significant, as it is possible that the peculiar context of the analysis, which includes only the generally homogeneous EU countries, limits the significance of this variable[15].

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15 *In other versions of our model we have applied the logarithm of per capita GDP, often used in similar studies, as an explanatory variable, with insignificant results aside from a strong correlation with the size of the banking system.*

More interesting is an interpretation of the sector-specific variables. In particular, our estimates highlight two significant phenomena:

- Countries with less room for domestic growth owing to a high degree of concentration (N5F) and low interest margins (NIMF), encourage greater FDI activity on the part of local banks. Although this consideration may appear obvious, it suggests that as space for consolidation on domestic markets gradually runs out, we will increasingly see the banks reposition themselves on the wider market and become involved in cross-border mergers and acquisitions, leading to the creation of true 'European banks'[16].

- Investment tends to flow into countries where the market potential is greatest, and more particularly, into countries with a highly-profitable banking system but low efficiency, which gives the investor a competitive advantage.

The first of these points is particularly interesting, and partly contradicts the findings of Focarelli and Pozzolo. It is likely that our dependent variable, which takes account of banking system strategies, enables us to observe a trend which is partly concealed in terms of single banks. The other results are in line with those emerging from other studies. Finally, in accordance with the results shown in the ECB's occasional paper of 2000 (2000), there is no evidence in our own study that the size of the receiving system has a significant effect on investment flows. Other variables too, like the spread on the originating banking system, or its average efficiency, do not appear significant.

In conclusion, our econometric evaluation enables us to state that competition and a lack of room for growth on domestic markets encourages European banks to expand into the rest of the EU, choosing countries with the greatest growth prospects and the most profitable banks, but where improvements in efficiency are possible through the

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16 *A similar conclusion was reached in Standard & Poor's (2000).*

transfer of technology. There is also evidence of 'follow the client' strategies being adopted.

A breakdown of the results by year appears to show that the variables relating to 'follow the client' strategies were of more importance in the first years of the period under consideration, whereas in 2000 the lack of room for domestic growth seems to have been more instrumental in expansion strategies. Although our results are only indicative, this trend shows a kind of evolution in European banks' internationalisation strategies, with the institutions slowly transforming from international banks serving a domestic clientele, into multinational banks wishing to exploit fully the potential of the EU market.

4. FOREIGN DIRECT INVESTMENT IN CENTRAL AND EASTERN EUROPE AND IN SOUTH AMERICA

Despite the potential of the market, for many banks cross-border growth strategies within the EU are still extremely burdensome, owing to the defensive attitudes still present in several countries. Moreover, expansion within the EU is difficult both financially and organisationally, and there are many problems in winning significant market share in local markets. In addition to this, the mergers and acquisitions implemented in Europe have up to now not led to a significant reduction in the excess capacity of the banking sector, nor to a slowdown in the downwards trend of interest margins. In many cases, the big improvements achieved by European banks have been largely dependent upon favourable economic conditions that have enabled them to significantly reduce provisions for credit risk of the banks they have acquired, or to sharply increase the revenues from capital market activities[17].

Given these factors, some institutions have focused their main growth strategies on expansion outside the EU, thus overcoming the limits and restrictions imposed by conditions on the European market. For these banks, the investment flows

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17 *This is one of the conclusions reached by Standard & Poor's (2000).*

channelled into emerging markets like those of central and eastern Europe and South America have become of fundamental importance[18].

The banking systems of these countries still have plenty of growth potential, as can be seen by the low level of banking activity, measured both as the ratio of bank deposits to GDP, and as loans to GDP. Although there are significant differences between all countries concerned, they nearly all have whole market segments which are yet to be developed, such as loans to small and medium-sized businesses and consumer credit. There are also good medium-term growth opportunities for the capital markets. Through acquisitions in these emerging countries, European banks can position themselves on markets which will take on increasing importance in the international arena, and at the same time increase the profitability of the local institutions through the injection of capital and skills.

Theoretical and empirical literature has highlighted several opportunities for bank investment in the emerging markets. As well as growth potential, the markets of South America and central and eastern Europe have traditionally offered ample margins for activity, thanks to wide bank interest rate spreads. It is also generally true that these margins tend to contract as the local economy develops and stabilises, and the banks must invest in improved efficiency and operational diversification.

It is important to note that, as they are entering less financially developed markets through operations like mergers and acquisitions, European banks often enjoy a competitive advantage over local operators. In these markets, it is generally easier for a bank to win significant market share and reach a size which enables it to

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18 *European banks' strategy of expansion into Asia has proved to be of less importance over the last few years. The after-effects of the recent economic crisis and the difficulties experienced by banks in making a recovery in the area have led to the shelving of strategies aimed at penetrating the Asian markets. However, some banks, mainly French, UK and Dutch, still have a significant presence in the area, which was generally built up before the crisis.*

achieve economies of scale and scope. Moreover, foreign banks can guarantee an injection of skills and capital to local banks undergoing a process of transformation, encouraging greater stability of the system[19].

M&A activity by European banks in South America and in central and eastern Europe has certainly been boosted over the last few years by the privatisation process launched in these two areas, and by the increasingly open attitude of the local banking systems to the entry of foreign investors. The convergence of banking regulations and supervision imposed by the minimum standards introduced at Basle has also led to greater protection of banking investors, warding off the risk of further system crises. In central and eastern Europe moreover, progress in the transition to a market economy, together with the harmonisation of laws in view of future entry to the EU for the ten candidate countries, are helping to create a legal framework which complies with European standards[20].

The first foreign direct investment in the banking sectors of central and eastern Europe dates back to the beginning of the 1980s. When the countries began the process of transition from Communism (end of the 80s), many European banks began to enter the area, mainly following their international clientele. The first investments were directly operative, through small subsidiaries or the acquisition of small local banks. However, since the various countries have begun to privatise their biggest banks, the strategy has changed radically. As new market opportunities have arisen, the European banks have begun strengthening their presence in the area through widespread market penetration, gained through the acquisition of controlling shares in the biggest local banks.

Austrian and German banks were the first to implement big expansion plans in the area, spurred by the strong trade links already existing, and by the intense activity of

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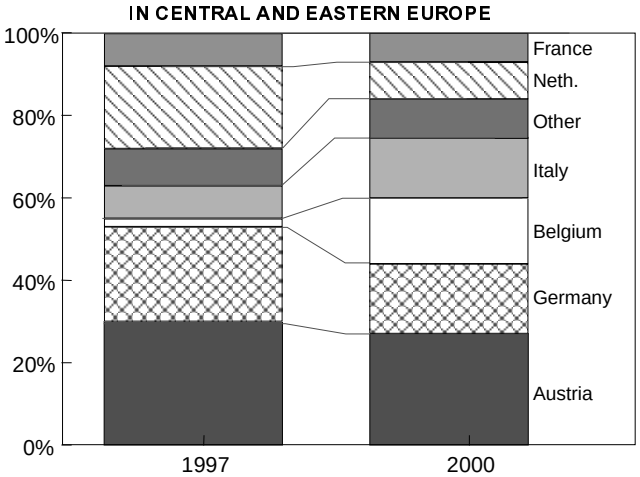
19 *See Claessens and others (2000), Papi and Revoltella (2000) and Focarelli and Pozzolo (2000).*

20 *Cf. Banca Commerciale Italiana (2000).*

national companies on the new markets. In 1997, the third-largest investor in the region was the Netherlands, through ING and ABN Amro, while Italy and France stood in fourth and fifth place, accounting for respectively 8% and 6% of foreign investment. The main single investor in the area was Bank Austria Creditanstalt, operating in Slovenia, Slovakia, Romania, Hungary, Poland, the Czech Republic and Croatia. This strategy of establishing a widespread presence was also pursued by ABN Amro and ING, respectively the second and third-biggest investors in the region.

Graph 2 – EU COUNTRIES' SHARE OF BANK FDI IN CENTRAL AND EASTERN EUROPE



Source: own estimates based on "Banks in CEECs database" data.

From 1997 the gradual privatisation of the big banks in these countries offered new and significant opportunities to European banks, which adopted a variety of different strategies. Whereas some continued to increase their presence without trying to win big shares of the local markets, others attempted to take on a leading role through important acquisitions. These strategies have changed the investment landscape in the region. A breakdown of investments by investing country in 2000 shows that, while Austria and Germany remain the biggest investors, with shares of 26% and

20% respectively, third place in the table is now taken by Belgium, with 19%, followed by Italy, with 15%, and the Netherlands, with 8%.

Belgium and Italy have increased their shares thanks to the participation of their banks in the privatisation of the biggest financial institutions in the region, a process which took off in 1999. Dutch banks, on the other hand, have not strengthened their presence, which is why their share of investments has fallen. In general, we can observe a marked shift by these banks away from retail and towards investment banking.

Foreign banks now control more than 60% of banking activity in central and eastern Europe, and over 80% of the investment comes from only five countries. The 15 biggest European banks account for around 90% of investment in the area, while the top four cover over 55%, highlighting the increasing concentration of investment.

The biggest investors in the area (see table 9) are medium-sized banks at a European level, such as KBC, Unicredito and Erste Bank. The growth strategies of these institutions has been dictated by restrictions encountered on their domestic markets. The impossibility of making important acquisitions nationally or in the EU has caused them to focus their expansion plans outside the single market, leading them to participate in the biggest privatisations in the area in the last two years.

In the same period, another area which has taken on fundamental importance for European banks' international expansion strategies is South America. Foreign banks began investing heavily in Argentina after the economic crisis of the early 1980s, so much so that all the country's biggest banks are now under foreign control. The influx of foreign capital to Brazil on the other hand began only a few years ago, but activity has been so intense that in a very short time more than 30% of the country's banking activity has come under the control of European or American banks.

Table 9 – THE BIGGEST EU INVESTORS IN CENTRAL AND EASTERN EUROPE – year 2000

Bank	Country	TA	FDI/TA	% FDI CEEC
KBC	Belgium	146.5	11.1%	18.7%
BAHypoVer	Germany - Austria	622.5	1.9%	13.3%
Erste Bank	Austria	51.8	19.2%	11.4%
UniCredito	Italy	168.9	5.6%	10.8%
ABN Amro	Netherlands	457.9	0.9%	4.9%
ING	Netherlands	492.8	0.7%	4.2%
IntesaBCI	Italy	302.8	1.2%	4.0%
Raiffeisen ZB	Austria	28.8	11.1%	3.7%
Bayerische LandG	Germany	268.2	0.9%	3.6%
Allied Irish B	Ireland	65.2	4.7%	3.5%
Commerzbank	Germany	369.4	0.6%	2.7%
Societe Gen	France	406.5	0.5%	2.4%
Deutsche Bank	Germany	805.5	0.2%	1.7%
Svenska Hand.	Sweden	107.5	1.4%	1.7%
Skand.Enskilda	Sweden	82.7	1.5%	1.5%
Crédit Lyonnais	France	172.9	0.5%	1.0%

Source: own estimates based on Bankscope data and "Banks in CEECs" database.

FDI CEEC: investments in central and eastern European countries in terms of total attributable assets. TA: last available balance sheet in December (1999 data). FDI/TA: weight of each bank's activity in the area. FDI accounts for 1999 total assets data and year 2000 shareholding. Figures in billion euro.% FDI CEEC: bank's share on total investments in the banking systems of central and eastern Europe.

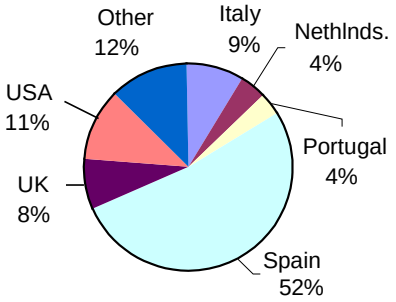
Graph 3 shows the breakdown of investment by investing country. We can see the leading role played by Spanish banks, which represent over 50% of investments. Both BSCH and BBVA now consider the South American market as an extension of their domestic market, and growth in the area is part of their global expansion strategies, as can be seen by the fact that activity in the region represents 25% and 17% respectively of the total assets of the two banks. In 1997 the two institutions were pursuing radically different strategies in the area: Banco Santander favoured taking controlling shares in small and medium-sized banks which were having

solvency difficulties and needed restructuring, while BBV was more interested in acquiring minority shares in big groups with good financial solidity. As time passed, the two strategies began to converge, and both BSCH and BBVA have actively participated in the privatisations launched in various countries, with the aim of gaining a leadership position, not only on single national markets, but also in the whole South American region.

An analysis of European banks' expansion strategies outside the EU reveals some interesting factors to consider:

- The first important point is that for some banks, investment in the emerging/converging markets is a real growth strategy. KBC, Unicredito and Erste in central and eastern Europe, like BSCH and BBVA in South America, have now achieved a considerable level of penetration in these areas, winning significant market shares, meaning that activity in the new markets is an essential part of their global strategies.

Graph 3 – FOREIGN INVESTMENT IN SOUTH AMERICA BY INVESTING COUNTRY – year 2000



Source: own estimates based on Bankscope data. Assets 1999 and ownership 2000

- The banks with the greatest presence in the new markets are generally medium-sized in European terms. The big EU banks appear to be focusing more on national growth, or on cross-border expansion within the EU.

- We can observe that foreign direct investment is heavily concentrated. In South America, only two banks account for almost 50% of foreign investment, while in central and eastern Europe, four banks control an even higher share. These institutions have acquired a leadership role on the market. As time passes and the number of privatisations tails off, we believe that it will become increasingly difficult for any banks left behind to gain significant market share in either region.

- We can also observe a trend whereby some banks are transforming from international to multinational institutions. Although a few years ago, expansion on the new markets was mainly the result of a desire to follow the client abroad, today the banks are concentrating fully on these markets, and are specifically interested in taking advantage of their potential, attempting to reach a critical mass which allows them to exploit this fully.

5. INTRA-EU AND EXTRA-EU INTERNATIONAL GROWTH STRATEGIES: CAN THEY WORK SIDE BY SIDE?

Up to now, our analysis has highlighted the strong focus of European banks on international growth strategies. One point, however, remains to be clarified: whether the banks which choose to expand outside the EU are structurally or operationally different from those whose growth is concentrated within the EU.

To answer this question, we have taken a sample of the biggest European banks[21]. We have considered only the biggest because these are the only banks with significant overseas expansion policies; smaller institutions, in contrast, are not geared towards internationalisation. We have then grouped the banks according to their relative presence in EU countries outside their own, or in emerging markets. The first group, which we have called Group 1, includes all those institutions focusing

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21 *Here we have considered all EU-based commercial, savings and co-operative banks with total assets of over €15 billion.*

mainly on the extra-EU markets, while the second, Group 2, considers banks operating principally in the EU. Group 0 consists of banks which have not launched internationalisation strategies either in Europe or in the emerging markets.

Table 10 shows the main features of our sample of 90 banks that satisfy our initial selection criteria, divided into the three groups. For each group we have also shown the average values of some of the variables of single banks or the countries in which they operate. These figures enable us to give a preliminary approximation of the structural and operational differences between the three types of banks. It is immediately clear that the banks which have expanded mainly in the EU are also the biggest institutions in terms of size (lnTA), of market share in the whole of the EU (QUE) and of market share in the domestic banking sector (QN). We can also observe a kind of progression, whereby the non-internationalised banks are also those with the lowest market share, followed by banks present outside the EU and then by those who operate on the whole of the single market. This observation is also confirmed by the test for equality of means in terms of share of the EU market between Group 1 and Group 2.

Looking at the importance of credit activity, a significant divergence between the group averages emerges. The banks with the greatest presence outside the EU markets are also generally those with a higher level of loan activity, shown in the table by a higher NLTA value. The other company variables do not show significant differences between the groups. At a system level, the banks with greatest focus on the emerging markets tend also to be based in countries where the national banking system is most concentrated (N5F). It is also true, however, that this greater concentration generally acts as a stimulus for international expansion strategies.

Finally, we have built a multinomial logit model which compares the growth strategy adopted by a bank with its specific internal characteristics and other variables pertaining to the system and country of origin. The dependent variable (dip) has been calculated taking account of the groups above. The value 0 therefore refers to banks

which have not adopted internationalisation strategies, 1 to strategies concentrating mainly on non-EU emerging markets, and 2 to strategies focused on EU countries other than the country of origin. We have redefined the coefficients in terms of relative risk, and the control model is model 2; that is, the intra-EU international expansion strategy. The object of the exercise it therefore to calculate:

Table 10 – INTERNATIONALISATION STRATEGIES OF THE BIGGEST EUROPEAN BANKS

	Group 0 – Non-internationalised: 32 banks		Group 1: Internationalised outside the EU: 10 banks		Group 2: Internationalised within the EU: 48 banks		Test for equality of means Group 1 and Group 2
	Average	*St. Dev.*	*Average*	*St. Dev*	*Average*	*St. Dev*	
lnTA	17.312	0.594	18.354	0.843	18.559	1.033	
QUE	0.279	0.228	0.832	0.551	1.265	1.239	**
QN	4.254	4.347	15.374	8.498	15.526	14.487	
NLTA	49.161	29.989	57.162	12.849	51.163	14.228	**
ROE	11.948	5.807	15.585	3.377	15.114	10.708	
CTI	58.535	25.664	61.598	7.917	65.225	13.033	
NIRA	1.568	1.174	1.991	0.604	1.658	0.808	
OOIA	1.207	2.050	1.136	0.472	1.289	0.948	
ETA	4.408	2.940	4.673	0.962	4.433	1.659	
N5F	40.315	16.761	54.634	16.490	46.713	23.862	**
CTIF	64.980	6.674	65.398	3.280	67.037	5.805	
ROEF	11.930	3.657	10.489	4.518	12.182	6.354	

Source: own estimates based on Bankscope data.

LnTA: logarithm of total bank assets; QUE: bank's percentage market share of the EU market, calculated in terms of total assets; QN: bank's market share of the domestic market in terms of total assets; NLTA: ratio of loans to total assets; ROE: Bank's return on equity; CTI: ratio between operating costs and total operating income; NIRA: ratio of interest margin to assets; OOIA: ratio of other operating income to assets; ETA: ratio of equity to total assets; N5F: index of concentration of the banking system in which the bank operates; CTIF: ratio of operating costs to total operating income of the system in which the bank operates; ROEF: ratio of operating costs to average ROE of the system in which the bank operates.

***: indicates a significant difference between the average of Group 1 and Group 2 at 90%.*

- The relative probability of a bank's opting for an extra-EU international expansion strategy over an intra-EU strategy ($\frac{P(y=1)}{P(y=2)}$) – Model 1;
- The relative probability of a bank's opting for a non-internationalisation strategy over an intra-EU strategy ($\frac{P(y=0)}{P(y=2)}$) – Model 2.

Table 11 shows the results of these calculations. The model has a pseudo-R square of 0.369. We can observe that the relative probability of extra-EU investment over intra-EU investment is positively associated with the degree of concentration existing on the domestic market of the investing bank (N5F). The more concentrated the system, the greater the relative probability of this growth strategy being adopted. The profitability (ROEF) and efficiency (CTIF) of the domestic banking system also affect the relative risk ratio. In particular, the greater the profitability, the lower the relative probability of a bank's expanding into emerging markets. This is because strategies of growth on these markets are often triggered by the wish to offset a lack of dynamism on the domestic market. As regards the second variable, there is a negative link between inefficiency and the relative risk ratio: as the ratio of costs to total operating income contracts, the probability of expansion on the extra-EU markets increases.

We have included several company-specific variables in our calculations, and the model does not consider those which did not produce significant results. We can observe that the ratio of loans to assets (NLTA) has a positive and significant impact on the relative probability of extra-EU over intra-EU investment. One possible reason for this is the fact that the increasing integration of the EU banking system over the last few years has gradually made it less necessary for institutions to have a physical presence in another EU country. At the same time, however, it has become of increasing strategic importance to have such a presence on the emerging markets. In these countries, the well-established presence of a western bank, able to offer not only standard products but also consultancy, geographic monitoring and information services, is a crucial tool in assisting the internationalisation of the traditional sector. For this reason it is possible that institutions which focus strongly on the loans

business, and which are situated in highly internationalised countries, tend to favour extra-EU over intra-EU growth strategies.

The last variable considered is the investing bank's share of the whole EU banking market (QUE). We can observe that, whereas the variable is not significant in the model which compares the relative probability of extra-EU over intra-EU investment, the alternative model showing the relative risk of non-internationalisation over intra-EU investment is the only significant variable, giving a negative coefficient. This result confirms the empirical evidence already presented: that the biggest European banks tend to grow mainly on the domestic or EU markets, while the institutions which are particularly active outside the EU are generally of medium size in European terms.

Table 11 – INTERNATIONAL GROWTH STRATEGIES OF THE BIGGEST EU BANKS: MULTINOMIAL LOGIT MODEL

	Coeff.[22]	Std. Err.	Z	P>|z|
P(y=1)/P(y=2) – relative probability of extra-EU over intra-EU investment – MODEL 1				
QUE	1.549	0.757	0.895	0.371
NLTA	1.059	0.359	1.716	0.086
ROEF	0.517	0.111	-3.072	0.002
CTIF	0.649	0.100	-2.802	0.005
N5F	1.073	0.031	2.456	0.014
P(y=0)/P(y=2) – relative probability of non-internationalisation over intra-EU investment – MODEL 2				
QUE	0.019	0.020	-3.675	0.000
NLTA	0.983	0.015	-1.144	0.253
ROEF	0.883	0.093	-1.178	0.239
CTIF	0.869	0.089	-1.370	0.171
N5F	0.983	0.017	-0.997	0.319

22 *Coefficients have been transformed in terms of relative risk. The sign of the non-transformed coefficient can be inferred from the value of z.*

To summarise the results of this econometric exercise, we can observe an operational and structural difference between the banks which have chosen to expand on the EU market, and those that have opted to focus on the emerging markets. The sector-specific variables are once again important in outlining banks' strategies. Market concentration, profitability and efficiency all have an impact on the choice of growth strategy; that is, whether it is intra- or extra-EU. In terms of single companies, the level of loan activity of a bank is an important variable, while market share in the EU system appears to have more of an impact on the decision to expand inside the EU, than on that of growth in the emerging markets. In general, the study seems to confirm the view that different types of banks choose different growth strategies, owing partly to the difficulties still existing in developing a real growth strategy on the single European market.

6. CONCLUSIONS

Over the last few years European banks have begun planning growth strategies on the new integrated EU market. With the help of our specially built database, this analysis shows that the relative degree of openness of the various European banking systems is increasing over time. Some countries can be stated to be net receivers or net investors, while others, like Italy, Germany and France, have adopted a strategy of balanced internationalisation for their incoming and outgoing investment. We can also observe significant cross-holdings between the biggest banks, activity which can be considered as a first prudent step towards European integration, and possibly the prelude to future mergers.

The analysis of the determinants of foreign direct investment by banks in the EU shows that cross-border growth strategies have been only partly (and mainly in the early years) driven by banks' desire to follow their clients into new markets. Today, the opportunities offered by the new markets, and more importantly the lack of potential for growth in the country of origin, appear to be the main determinants of international expansion strategies. It is therefore likely that, as the margins for growth

within national boundaries shrink, the big European institutions will increasingly look towards expansion on the EU market, leading to the creation of true pan-European or multinational banks.

Some European banks have also developed aggressive expansion strategies on the emerging markets over the last few years. In general, we can see operational and structural differences between the banks which have decided to grow on the EU market and those which have opted to focus on the new markets of central and eastern Europe and South America. Sector-specific variables once again demonstrate their importance in outlining banks' growth strategies. The degree of concentration of the domestic market, its profitability and efficiency, all have an impact on the choice of international expansion strategy; that is, whether it is intra- or extra-EU. In terms of single companies, the level of loan activity of a bank is an important variable, while market share in the EU system appears to have more of an impact on the decision to expand inside the EU, than on that of growth in the emerging markets.

The analysis therefore seems to be confirmed that different types of banks choose different growth strategies, owing partly to the difficulties still existing in developing a real growth strategy on the single European market.

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