

Press Release 8/2019

Halle (Saale), 2nd April 2019

Bank profitability increases after eliminating consolidation barriers

When two banks merge because political consolidation barriers are abolished, the combined entity is considerably more profitable and useful to the real economy. This is the headline result of an analysis of compulsory savings banks mergers carried out by the Halle Institute for Economic Research (IWH). The study yields important insights for the German and the European banking market.

Government support of the ailing Norddeutsche Landesbank on the order of 3.5 billion Euros appears in a different light if you consider that (1) with more than 1,800 banks, Germany has more credit institutions than any other country in Europe and (2) many banks only generate very low profits, which as a consequence (3) can pose a danger to financial stability. The main reason is that sustained sclerotic profitability raises risk-taking incentives of banks.

A team from the Halle Institute for Economic Research (IWH) investigated a special-case scenario. In Germany, when districts are amalgamated as a result of territorial reforms, their savings banks must also amalgamate. This 'merger shock' permits the isolation of the causal connection between the consolidation of regional banks and the development of their profitability potential after such a transaction, and to separate this from other factors such as the regional economic situation. 1,627 savings bank mergers between 1993 and 2015 were investigated. The researchers compared the newly created institutions with cooperative banks that had either merged voluntarily, or not merged at all. The results showed that the savings banks subjected to compulsory mergers increased their profitability by 5–6 percentage points compared with cooperative banks. Against the backdrop of an average return on equity of 8 percentage points, this magnitude is economically significant. The effect lasts for up to eight years after the merger. The essential drivers of this higher profitability are lower equity investment, easily increased credit risks, and lower operating costs.

The researchers also looked at the consequences of a compulsory merger for the bank's corporate customers relative to those of non-forced savings banks mergers. Corporate cost of credit fell by 0.25 percentage points and these customers connected to forced mergers invested up to 50% more in the three years following the bank merger. In the longer term they increased employment between 1% and 2%.

Michael Koetter, Head of the Department of Financial Markets at IWH and co-author of the study, draws the following conclusions from the survey. "In Germany, there are too many banks scrambling for increasingly smaller revenues. Structurally poor profitability in the sector can put financial stability at risk." Moreover, says Koetter, because digitalisation makes banking transactions easier,

no press embargo

Press contact

Rafael Barth

Tel +49 345 7753 832

presse@iwh-halle.de

Scientific contact

Michael Koetter

Tel +49 345 7753 727

mkr@iwh-halle.de

Keywords

financial markets, financial crisis,
financial institutions, financial
stability

Political departments

Federal Ministry of Finance (BMF),
Federal Ministry for Economic Affairs
and Energy (BMWi), Federal
Chancellery, Federal Ministry of
Labour and Social Affairs (BMAS)

[Halle Institute for Economic
Research \(IWH\) – Member of the
Leibniz Association](#)

Tel +49 345 7753 60

Fax +49 345 7753 820

Kleine Maerkerstrasse 8

D-06108 Halle (Saale)

Germany

P.O. Box 11 03 61

D-06017 Halle (Saale)

Germany

www.iwh-halle.de

fewer financial institutions are needed. Excessive pressure to succeed resulting from overcapacity increases the risk of a new financial crisis which, once again, could cost a lot of taxpayers' money.

Koetter therefore pleads for a reduction in the political barriers to bank mergers. "We need more intelligent and courageous consolidation that crosses borders – borders in Europe and the rest of the world, but also the national borders between the pillars of our banking system as it has evolved historically. It is too fragmented for today's demands." Up to now, mergers between the three pillars of the German banking system (savings banks, cooperative banks, commercial banks) have been forbidden. "Completing the European banking union by establishing a fully mandated deposit guarantee system is an important step towards fewer cross-border consolidation barriers," says Koetter. Such an elimination of merger frictions would render dearly needed pan-European mergers involving German banks more attractive for foreign investors. In Koetter's view an international solution instead of the discussed merger between Deutsche Bank and Commerzbank would make more sense. "Experience shows that, in the banking world too, you can't make a two-legged sprinter out of two one-legged walkers."

Publications

Koetter, Michael; Müller, Carola; Noth, Felix; Fritz, Benedikt: *May the Force be with You: Exit Barriers, Governance Shocks, and Profitability Sclerosis in Banking*, in: Deutsche Bundesbank Discussion Paper 49/2018, Frankfurt am Main 2018.

Koetter, Michael: *Es ist nicht genug für alle da* [It's not enough for everyone]. Op-ed for: *Süddeutsche Zeitung*, 1st April 2019, p. 16.

Scientific contact

Professor Michael Koetter, PhD
Tel +49 345 7753 727
Michael.Koetter@iwh-halle.de

Press contact

Rafael Barth
Tel +49 345 7753 832
presse@iwh-halle.de

 IWH on Twitter
 IWH on Facebook

The IWH [list of experts](#) provides an overview of IWH research topics and the researchers and scientists in these areas. The relevant experts for the topics listed there can be reached for questions as usual through the IWH [Press Office](#).

The Halle Institute for Economic Research (IWH) – Member of the Leibniz Association was founded in 1992. With its three research departments – Macroeconomics, Financial Markets, and Structural Change –, IWH conducts economic research and provides economic policy recommendations, which are founded on evidence-based research. With the IWH's guiding theme "From Transition to Euro-

pean Integration". the institute's research concentrates on the determinants of economic growth processes with a focus on efficient capital allocation in a national and European context. Particular areas of interest for the institute are macroeconomic dynamics and stability, microeconomic innovation processes, productivity and labour markets, the dynamics of structural adjustment processes, financial stability and growth and the role of financial markets for the real economy.

The Leibniz Association connects 95 independent research institutions that range from the natural, engineering and environmental sciences via economics, spatial and social sciences to the humanities. Leibniz institutes address issues of social, economic and ecological relevance. They conduct knowledge-driven and applied basic research, maintain scientific infrastructure and provide research-based services. For further information see <http://www.leibniz-gemeinschaft.de/en/home/>.