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Belgian banks under stress

The effects of deregulation and financial innovation on the performance of the Belgian credit institutions

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Abstract

Many banking systems in the industrial world are passing a period of substantial structural change. In this contribution we offer a case-study for the Belgian credit institutions. We start with an overview of the characteristics of the Belgian financial sector and then discuss the process of deregulation and financial innovation in Belgium. This process took a long time to take off. Yet, at the end of the 1980s Belgian banks were faced with an impressive number of reforms as e.g. the new government debt management, the introduction of new monetary policy techniques and the reduction of the withholding tax.

The central point of the article is that these reforms have far-reaching consequences for the performance of the Belgian banks. Several effects appear in review : the higher costs of funds, the lower intermediation margin, the shift in lending portfolio, the declining profitability, the increased risk profile, and the effect on bank liquidity management.

In the last section we discuss some key elements for Belgian banks in the 1990s : a tendency toward de-intermediation, a lower net interest margin, a rising share of non-interest income, the need for further cost controls and a potentially higher level of loan-loss provisions. We also speculate on the various possibilities for sector consolidation.

In many industrialized countries the banking system is passing through a period of substantial structural change. Increasing internal competition, deregulation and re-regulation, new technological developments, European and global competitive pressures, etc. have put many financial systems under increasing stress. Llewellyn (1992) offers a general account of the various cyclical, structural and secular pressures on banks, of their resolution and of their likely effect on the sector's equilibrium. In this contribution we offer a case study for the Belgian credit institutions (see also the Banker, 1990, 1992; Moody's, 1992).

1. Characteristics of the Belgian financial sector

In Belgium the process of financial deregulation and innovation took a long time to take off. Through the 1980s, the Belgian banking system saw only minor structural changes compared with other European countries. However, at the end of the decade and especially during 1990 and 1991 Belgium instituted a radical reform of its money and capital market with a succession of new measures.

In order to evaluate the importance of these measures and their effect on the financial intermediaries it is useful to start with an overview of the main characteristics of the Belgian financial sector in the 1980s (see Belgische Vereniging van Banken, 1990). This is the purpose of this section.

a) Fragmentation, diversification and saturation

In total approximately 130 different credit institutions are active on the Belgian market. They belong to one of the three groups of financial intermediaries : the private commercial banks, the private savings banks and the public credit institutions[1]. Functional differences between these groups still exist but have become more and more vague. Among these three sectors of credit institutions banks have by far the largest market share (see table 1).

Table 1

There is tough competition on the domestic market, also because of the existence of many specialised institutions (only about 10 credit institutions exercise all bank activities) and the presence of many branches of large foreign credit institutions. This also explains the fragmentation of the Belgian financial sector into a large number of relatively small institutions and the present situation of saturation.

b) **High degree of intermediation**

In contrast with e.g. the USA and the UK, and similar to Germany, Belgium is characterized by a high degree of financial intermediation. Credit institutions still play a prominent role in channeling savings to deficit spenders. There are several explanations for this. First, the government has in the past relied heavily on the Belgian credit institutions for the financing of the public debt. During the 1980s government debt offered the Belgian banks a risk-free investment at an attractive yield (the government made use of a fixed subscription bank consortium, that could act as a monopolist, to place the public debt). Also in the past banks could realize tax-free capital gains on the sale of

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[1]. There are 90 commercial banks registered in Belgium. The three largest are Generale Bank (Générale de Banque), KB (Kredietbank) and BBL (Bank Brussel-Lambert; Banque Bruxelles-Lambert). Their combined balance sheet represents half of the total commercial banks' assets. Further, there are about 28 registered private savings banks, the most important being CERA and BACOB (combined balance sheet equals 2/3 of total private savings banks' assets). Among the six state-owned credit institutions the most important are Gemeentekrediet (Crédit Communal) and ASLK-CGER bank. (figures for 1991)

Belgian public bonds coming from their investment portfolios. This, together with the high borrowing appetite of the Belgian government (see below) explains the overwhelming share of government debt in the portfolios of the Belgian banks (two-thirds of outstanding government debt is held by Belgium's commercial banks, private savings banks and state-owned credit institutions; see table 2).

Table 2

The corporate sector also remained very bank-intermediated in Belgium. The share of business investment funded by bank lending is high, compared to that financed by corporate equity and bond issues. This is explained by the strong presence of small and medium-sized companies and by the fact that especially in the corporate market there always existed tough price competition between banks in the granting of credit. Indeed, because of their privileged role in lending to government, credit institutions competed for loans to industry by offering very attractive terms. This made intermediation relatively cheap for the business firms, who consequently were (and still are) not very attracted by the capital market. Also, the sheer size of the public-sector debt outstanding made the growth of a nonpublic financial market in Belgium impossible.

One of the typical features of the Belgian economy is the high savings rate of households. Some disintermediation occurred, however, with respect to the Belgian savings. In the 1980s these have been largely disintermediated away from the banks' balance sheets, mainly for fiscal reasons. High withholding taxes (first 20%, later 25%) have driven a large share of Belgian savings outside the country. As a consequence, banks had to compensate this loss in savings by attracting short-term funds in the money market and through time deposits.

c) **High density of branches network**

Another typical feature of the Belgian financial sector is the high density of bank offices. Belgium being characterised by a high savings ratio, Belgian commercial banks, savings banks and public credit institutions have invested heavily in the development of their branches network in a period when price competition between financial institutions was still moderate and savings could be attracted at moderate and more or less stable rates (table 3). In the present context of high price competition the question may be asked whether there are not too many bank offices.

Table 3

d) **Internationalisation**

The Belgian financial sector is further characterized by a high degree of internationalisation. There is a striking presence of foreign banks (mostly subsidiaries of large foreign banks) on the Belgian domestic market. This feature is asymmetric : contrary to the activities of the foreign banks on the Belgian market, the international activities of the Belgian banks have been mostly constrained to the interbank market.

e) **Delayed financial innovation**

Belgium has got behind in the development of financial markets. Until recently e.g. there was no market for futures and options and in general the organisation of the stock exchange was outdated. Also an Euro-BF market was lacking. The causes for this relative underdevelopment of financial markets are manyfold and include the monopoly position that was held by the stock exchange brokers, the one-sidedness of the bond supply (only government bonds) and certain fiscal stipulations (e.g. withholding tax of 25%; taxes on stock exchange).

f) **High asset quality**

Compared with their international counterparts, the large Belgian banks have been less hurt by asset quality problems. The reasons for this are : (a) the preponderance of bank lending to the public sector; (b) the fragmented and less mature structure of the domestic market - in which a large share of business credits went to the major corporations, and in which most retail loans were mortgages; (c) a good performance of the Belgian economy in the late 1980s; and (d) the more conservative lending culture of many Belgian bankers, who were able to avoid large international concentrations in commercial real estate, developing countries, and other risky sectors like leveraged buy-outs and management buy-outs (Cockaerts, 1992). The fact that Belgian banks are less involved in lending to developing countries, as compared to international banking systems, can also be explained by their relative undercapitalisation and the high capital requirements imposed by the prudential authorities on these forms of credit (E. Deweirdt, 1986).

g) **Profitability and solvency**

Perhaps the most important characteristic of the Belgian credit institutions is their weak performance in terms of profitability and solvency. Belgian banks labour under some of the lowest overall profit margins and weakest capital ratios in Europe (see table 4). This is a serious handicap when it comes to absorbing the negative effects on profitability of deregulation and increased competition, especially during the transition period before a new sector equilibrium is reached.

Table 4

2. Deregulation and financial innovation in Belgium

At the end of the 1980s Belgian banks were faced with a rapidly changing market which turned many credit institutions' franchise value more uncertain. An impressive number of reforms were introduced motivated by the desire to expand Brussels into an international financial centre, to prepare Belgium for the European Monetary Union, to give the monetary authorities a more decisive influence on the money market and to reduce the interest burden of the national debt (Lierman, 1992a). The most important reforms are : (a) the new government debt management; (b) the introduction of new monetary policy techniques; (c) other measures to improve the efficiency of the Belgian financial markets and (d) deregulation measures. We briefly deal with each of them in this order.

a) **The new government debt management**

In 1989 new debt management techniques were introduced against the background of a number of years of fiscal austerity and a declining borrowing requirement. Since the early 1980s Belgium's budget deficit has fallen from 15% of GNP to about 6%. However, total outstanding debt remains very huge (130% of GNP) and interest payments alone absorb about 10% of GNP.

In an effort to lower public borrowing costs and to help lower the deficit, the government bond market was radically revised, to make it more liquid and more efficient and to increase the attractiveness of government bonds to foreign investors. Under the new system, OLOs[2] with fixed coupon, maturities and redemption prices are issued by the Belgian government at

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[2]. Obligations Linéaires/ Lineaire Obligaties.

competitive auctions not only to Belgian banks but also to other Belgian and foreign institutional investors[3].

Another innovation with respect to the new government debt management was the introduction in 1990 of Public Bonds for private savers[4] which circumvent the relatively high commission on government bond issues which before was received by the underwriting bank consortium.

Last but not least, in January 1991 the government started with issuing standardised short-term treasury certificates, with weekly issues of one, three and six-months maturities and monthly issues of nine and twelve-month maturities. A real treasury bill market was created, open to banks and nonbanks - including foreign investors. In this new system, treasury bills are auction-issued on a competitive basis. The same reform also created a secundary market for treasury bills.

b) **The introduction of new monetary policy techniques**

The 1991 reform aimed at creating a true money market in Belgium, mainly by uncoupling monetary policy from the treasury certificate market. Before the National Bank simply set the interest rate on short-term treasury bills. This rate constituted the official rate on the money market. Under the new system, the interest rate on treasury certificates has been displaced by real money market intervention. Belgian monetary policy is now mainly based on weekly allotments of credit. A weekly call for tenders is open to all Belgian financial institutions. Tenders can be expressed in terms of interest rates or of quantities. In this way the National Bank can better affect liquidity and the interest rate in the money market. In addition to these weekly tenders the

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[3]. At the same time, the tax advantage of capital gains on government bond sales was scaled down in 1990.

[4]. Emprunts Populaires/ Volksleningen.

National Bank has a number of specific fine-tuning instruments to influence the money market (repurchase agreements, open-market operations and overnight credit).

c) **Other measures to improve the efficiency of the Belgian financial markets**

Other measures to improve the efficiency of the Belgian financial markets include the launching of the Brussels Stock Exchange's computer-assisted trading system (CATS) with centralized price formation, the creation of new markets, such as a financial futures and options market (BELFOX), the authorization given to banks to issue mutual funds denominated in Belgian francs and administered in Belgium, and the power to securitise mortgage loans. The 1991 reform also established a domestic commercial paper market for corporate issues.

A very crucial financial market reform was the reduction of the Belgian withholding tax on new investment from 25% to 10% on March 1, 1990 (limited to bond and bank interest revenues) with far-reaching consequences for the cost of funding (see below). It was hoped that this measure would help reintermediate Belgian savings invested abroad. This was followed by the abolition of the two-tier exchange market and the coupling of the BF to the strongest currency in the EMS.

Another provision of the 1991 reform is that, for the first time, banks, insurance companies and other institutions (Belgian and foreign) can own and operate domestic stockbrokers, which were free to incorporate as stock exchange companies, thus offering banks an additional source of fees and commissions.

d) **Bank deregulation**

Through the 1980s, Belgian bankers' activities have been cramped by government price controls, out-of-date legislation governing financial markets and an unreformed stock exchange cartel. Tight price controls on retail banking services further meant that cheque accounts were free or substantially below cost to the personal customer.

However, bank deregulation is now in an advanced phase. Through the Belgian Banks' Association, the banks have dropped their out-of-date arrangement to fix interest rates (see BvB, 1992). Also, starting in 1992, Belgian banks are charging customers for their banking transactions - and are thereby trying to recover the high money-transmission expenses. One of the recent measures is the removal in 1993 of legal restrictions on offering variable-rate housing loans.

Restricted rates on passbook savings with tax-free status still exist and to some extent this system still has a moderating influence on banks' funding costs. However, the Minister of Finance has already announced the abolition of the tax-free status and the restriction on interest rate setting for these regulated passbook savings. Also, Belgian banks cannot yet fully engage in universal banking (restrictions on participations by banks in nonfinancial companies).

3. Effects of the reforms on the Belgian financial intermediaries

The previous overview showed that at the end of the 1980s and the beginning of the 1990s Belgian banks were faced with a fast-changing market. Not only were they confronted with a series of new government measures among which the most important were the reform of the government debt management and the reduction of the withholding tax. On top of these new measures banks were facing a number of global and European challenges like the new capital requirements (international re-regulation) and the opening of the financial services market (Europe 1992). And above all, competition has intensified strongly in the past few years. As will be shown in this section these were all important factors determining the performance of the Belgian credit institutions.

A convenient way to illustrate the various pressures on banking is offered by equations (1)-(3) below, adapted from Hannan (1991), which formalize the profit determinants and the constraints affecting banking (capital adequacy constraint and bank balance constraint).

(1)
$$P = \sum_{n=1}^{N} (i_n^L - c_n^L) L_n + (i_s - c_s) S - \sum_{m=1}^{M} (i_m^D + c_m^D) D_m + NI - C_f$$

(2)
$$\left(K \,/\, \sum_{n=1}^{N} a_n L_n \right) \geq 0.08$$

(3)
$$\sum_{n=1}^{N} L_n + S = \sum_{m=1}^{M} (1 - r_m) D_m + K$$

with :

P	:	profits
i^L_n	:	the interest rate associated with the n-th category of loan held by the bank
c^L_n	:	variable non-interest costs per BF of the n-th category of loan held by the bank
L_n	:	the amount of the n-th category of loans
i^D_m	:	interest rate associated with the m-th category of deposit
c^D_m	:	variable non-interest costs per BF of the m-th category of deposit

D_m	:	the amount of the m-th category of deposits
i_s	:	interest rate associated with government securities (treated as one single security)
c_s	:	variable non-interest costs per BF associated with government securities
S	:	the amount of government securities held by the bank
NI	:	non-interest income
C_f	:	fixed costs
K	:	bank's capital
a_n	:	risk weight of loan n
r	:	cash reserve ratio

With the above model in mind the following pressures on the various volume and price variables can be detected.

a) **Higher costs of funds** (i^D_m)

For a long time maximum levels for credit interest rates were set by the 'Consultation Committee for the Harmonization of the Credit Interest Rates'[5] (with participation of the private commercial banks, private savings banks and public credit institutions, each acting as a leader for certain deposits). This system was applied for the interest rate on sight deposits, passbook savings, small and medium sized time deposits (till 5 million BF), and for certificates of deposits. However, as a result of the outflow of savings outside the country (mainly to Luxembourg and the Netherlands) the system came under stress at regular times. More recently, the reduction of the withholding tax and the reform of the money and capital market have stepped up the process of deregulation. At present the system of interest rate fixing has almost completely disappeared (with the important

[5]. 'Overlegcomité voor de Harmonizering van de Creditrente-tarrieven'.

exception of the interest rate on tax-free passbook savings that is controlled by the government). See Belgische Vereniging van Banken (1992).

The immediate (and to some extent unforeseen) effect of lowering the withholding tax has also been a shift in Belgian banks' deposits mix from short-term (and lower-rate) passbook savings into long-term higher rate deposits. Before the lowering of the withholding tax, Belgian-based savings in financial assets were directed largely into tax-free passbook savings which have regulated rates and thus offer lower yields, and to a lesser extent into longer-term higher yield (but tax paying) bank instruments.

With the reduction of the withholding tax, tax-free passbook savings lost a lot of their attractiveness, since the lower rate was no longer compensated with tax relief. Consequently, there has been a shift out of passbook savings into more expensive deposits like time deposits and certificates of deposits (D_m). Figures 1 and 2 illustrate the shift in the deposit mix which has continued until 1992. The total amount outstanding on these tax-free passbook savings has decreased by more than 20% (from 2.300 billion in 1989 tot 1.800 billion BF in 1992).

Figure 1
Figure 2

In general the private commercial banks have suffered less from the negative effects of higher costs of funds generated by liability mix changes than private savings banks and state owned credit institutions. This can be explained as follows: (a) commercial banks have a larger share in their books of current accounts (which are less sensitive to interest rate changes); (b) they have a more diversified loan portfolio and thus can partially offset the negative effect of higher funding costs; (c) a smaller share of their credits are long-term at fixed rates, so that they are less caught in a repricing mismatch than the other credit institutions.

b) **Lower intermediation margin**

In spite of the existence until recently of a system of non-binding consultation among banks with respect to some debit interest rates[6] (i^L_n), bank lending to the private sector (corporate and household) has always been characterized by tough competition. Moreover, in 1991 the system of consultation was officially ended.

Also, for investment and housing loans (which were not included in the system of consultation), the fact that certain credit institutions acted informally as a market leader did in the past not prevent strong competition in this area. Consequently, the margin on bank lending to the private sector has always been very low (the margin on government lending to some extent constituted a subsidy from the public to the private sector).

The higher costs of funding, combined with lower asset yields from reduced return on public debt instruments (i_S) and from more competitive loan rates (i^L_n), has negatively affected the financial intermediaries' net interest margins. This is shown in table 5 for the private commercial banks and in table 6 for the private savings banks.

Table 5

Table 6

c) **Shift in lending portfolio**

As a result of the new government debt management the margin on government lending has decreased sharply. Consequently,

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6. 'Comité voor het Onderzoek van de Debetvoorwaarden'.

because government bonds have become less attractive investment for banks the volume of government bond holdings by banks has decreased significantly. Left without the exclusive control of the government bond market, Belgian credit institutions therefore intensified their expansion into new lending markets.

Commercial banks have been targeting the retail sector with success and thus diversifying their interest income base. More recently, public credit institutions and savings banks have reacted by expanding into commercial lending and into international activities as well. However, since deregulation and financial innovation were introduced in a period of weak economic activity, the volume of bank lending to the private sector did not expand significantly.

d) **Declining profitability**

Summing up, bank profitability is no longer influenced by the past peculiarities of the Belgian market - in particular by abnormally high government bond yields, tax-free capital gains, and inflow of low-rate passbook savings.

e) **Increased risk profile**

All Belgian credit institutions - albeit to different degrees - are witnessing a gradual rise in their business and asset risks. Bank profitability is therefore affected by higher levels of loan-loss provisions. Commercial lending and international activities are both risky areas for new entrants. Foreign activities are also an element of greater uncertainty for Belgian credit institutions in general, but especially for savings banks and public-sector institutions, which started their international expansion late, and began with less market expertise. All this implies that the Belgian banking industry is participating into the global trend of 'financial fragility' defined by the OECD (1992, p.127) as the 'deterioration of banks' balance sheets as a result of lower asset quality and lower net earnings'.

f) **Bank liquidity management**

The reform of the government debt management, together with the new monetary policy measures have radically changed the liquidity management of the credit institutions. Before the reform, treasury certificates dominated the liquidity management of the Belgian credit institutions. In the case of a liquidity surplus they could convert it into certificates at a predetermined rate and for unlimited amounts (treasury certificates were issued 'on tap'). Liquidity shortages were absorbed by not renewing treasury bills at maturity. One of the implications of the 1991 reform is that banks have to a larger extent to call on the secundary market for treasury certificates in the case of liquidity shortages and surpluses. Remaining shortages (surpluses) can be financed by (invested with) the NBB at penalizing interest rates.

4. Strategic issues

The problems of the Belgian credit institutions that were revealed in the previous sections are to some extent temporary in nature, due to the economic cycle and their adaptation to the new deregulated environment. It is indeed important to bear in mind that the deregulation and increased competition caught banks at a time when economic activity was weakening around the end of the 1980s (the average yearly growth rate of GNP in 1992-93 was 1.1%, compared with 3.6% for the period 1988-91). This explains to some extent why deregulation did not lead to a rapid rise in assets and overshooting (i.e. an expansion of bank lending to an excessive degree and beyond long run sustainable positions) as was the case in many other European countries (see Llewellyn, 1992). However, to point to the current stance of the business cycle as the main explanation of weak bank performance is to deny the decisive influence on banking resulting from the various measures and tendencies, both domestically and internationally, that have been identified in the previous sections.

In this respect it is interesting to note that commercial banks are generally better positioned to face the challenges of the 1990s than the savings banks. They have entered more actively into the retail sector (traditionally covered by savings banks) in the mid-1980s (e.g. consumer credit) and are in the forefront of new activities (leasing, various fee-generating services). At the same time, owing to strong long-standing relationships with Belgian companies (often through minority ownership by a common holding company) the big banks maintain a lock on the commercial banking business franchise.

Savings banks may meet more difficulties in upholding the value of their business franchise and in diversifying their activities. They remained more confined to their traditional markets and their net interest income still represents a high proportion of their revenues. Also, savers are becoming increasingly yield-demanding.

Key elements for Belgian banking in the 1990s are : (a) a tendency toward de-intermediation; (b) a lower net interest margin; (c) a rising share of non-interest income; (d) the need for further cost controls; (e) a potentially higher level of loan-loss provisions; (f) sector consolidation.

a) **De-intermediation**

Since 1991 Belgian and foreign companies have access to the market of Belgian treasury certificates. Consequently, treasury certificates now constitute an attractive alternative for (large) bank deposits of Belgian enterprises. The 1991 reform also established a domestic commercial paper market. Up till now the de-intermediation effects that could potentially result from these new opportunities have been quite modest and it is further to be expected that Belgium will remain highly bank-intermediated, as compared with other countries, in the future (dominant presence of small and medium-sized firms). Nevertheless, as a result of the new opportunities offered, the trend toward de-intermediation seems unavoidable.

b) **Interest margins**

Margins will continue to be under strong pressure through the 1990s, because of (a) rising funding costs coming from a shift in the liability mix toward more expensive resources, and (b) lower asset yields from reduced returns on public debt instruments and from more competitive loan rates.

c) **Non-interest income**

All banks are now striving to boost their non-interest earnings (NI). This has been done largely through offering new services and products to existing customers. A large number of banks entered into the insurance field ('bankassurance'). Belgian banks are now aware of the added commission potential of such activities. Stockbroking, primary dealership, foreign exchange and interest operations (swaps, futures) could generate more revenues as well, but competition for these services will make such earnings harder to come. Service charges (so far modest) will increase and become a more important share of banks' non-interest earnings.

d) **Cost controls**

In their effort to improve the profitability of their branch networks, Belgian banks will have to further control their expenses. In the long term, banks may have to reduce the vast number of their branches, since even though many of these branches are small, they contribute to high overhead.

According to Abraham & Lierman (1990) European banking in the 1990s will be characterized by a shift in emphasis toward the supply side in banking strategies. This implies a shift of attention from innovation and market penetration to restructuring and cost-cutting (internal optimization of existing resources).

e) **Loan-loss provisions**

The new business environment poses a number of challenges for the financial institutions. There is a real danger that they will reach to this new situation by switching to a more aggressive and riskier policy. Also, the possibility that banks now have to issue asset backed securities (while easing the need for capital) imposes a risk as low risk assets are in general easier to securitize. Further, the expansion of off-balance sheet activities is also not without risk, as many of these activities are relatively new for bankers.

f) **Sector consolidation**

In an analysis of the global pressures on banking, Llewellyn (1992) identifies six overlapping phases in the recent evolution of banking which in our opinion apply equally well to the Belgian situation. These phases are : (1) protective phase; (2) deregulation phase; (3) competition phase; (4) re-regulation phase; (5) excess capacity phase and (6) consolidation phase.

It is clear that Belgian banking is currently in phase (5) and that one can expect a period of consolidation in the years to come. Such consolidation can take various forms, viz. (1) failure and exit; (2) firms reducing the scale of their operations; (3) mergers between banks; (4) mergers with other non-bank firms.

As Abraham & Lierman (1990) show in a detailed overview there has already been a lot of external restructuring (mostly acquisitions, minority stakes, co-operative agreements and setting up of new specialized entities) in the Belgian financial landscape, but mergers (domestic as well as cross-border) have not yet occurred at a significant scale. In fact, the two well known examples of failed attempts at cross-border merger in Europe (viz. between the Belgian Generale Bank and the Dutch Amsterdam Rotterdam Bank, and between the Dutch ING and the Banque Bruxelles Lambert) illustrate the difficulties that have to be overcome in such mergers.

Nevertheless, all forms of consolidation remain open. The first solution is rather unusual for Belgium. However, in the years to come the intensification of banking competition is likely to increase exits. Takeovers may be an efficient and competitive way to organise such bank exits. As Muldur (1992a) argues they are the most common way of leaving the banking sector, preferred both by banks themselves as the best way to recover their investment costs, and by the regulatory authorities, conscious of the threat to the system from a succession of banking collapses. The third solution is favoured by the monetary authorities. The motivation for this view is not so much the supposed effects of scale or scope on bank performance. Empirical tests of economies of scale and scope in banking are indeed very inconclusive and rather point to the absence of any firm relationship between average costs or profitability and bank size (see e.g. Conti & Maccarinelli (1991) and Muldur (1992b) and for the Belgian banking sector Pacolet (1989), Gathon & Grosjean (1991), Pallage (1991) and Coppieters et al. (1992)). The rationale for mergers between Belgian banks is however to be found in the view that Belgian banks are currently too small to play a significant role in Europe and even to survive on the domestic market that will be characterized by increased contestability. Aside from cost considerations, large size does have certain advantages that escape formalization : greater placing power in international markets, favourable impact on bank reputation, easier development of new products, enlarged customer-relationship base. The idea is therefore to have some institutions that have chosen to be universal or pan-European. Another possibility is to have fat-shedding mergers between two Belgian banks (in which case internal rationalization and cost-cutting, rather than size would be the main goal). A merger between a partially privatized state-owned credit institution and a Belgian bank or insurance company (e.g. between ASLK/CGER and the Belgian-Dutch Fortis) also belongs to the possibilities. The fourth option has to some extent been used as most bigger banks have signed up brokerage houses and intensified their links with insurance companies.

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Table 1.

Market Share of private commercial banks, private savings banks and public credit institutions (1989).

	banks	public credit institutions	savings banks
Share of deposits			
sight deposits	72.5	21.4	6.1
time deposits	73.3	19.3	7.4
savings deposits	37.3	38.4	24.3
certificates of deposits	22.0	60.9	17.1
all deposits	47.9	37.2	14.9
Share of loans outstanding			
loans to private sector and to foreign sector	64.0	24.2	11.8
loans to the Belgian government	42.2	43.4	14.4
all loans	53.4	33.5	13.1

Source: Belgische Vereniging der Banken (1990)

Table 2.

Holders of Belgian government debt

(in %)

	1970	1980	1987
Financial Institutions			
Banks[(a)]	41.3	36.6	31.6
Other[(b)]	22.5	23.1	33.3
Total	63.8	59.7	64.9
Other			
Private sector	26.3	23.6	12.2
Public institutions	2.9	6.6	3.9
Foreigners	7.0	10.1	19.0

Source: data from Belgian Ministry of Finance reported in The Banker (1990)

(a) mainly deposit banks

(b) savings banks, mortgage companies, financing companies, insurance companies, pension funds and state-owned credit institutions

Table 3.

Density of branches network and persons employed in the financial sector (1990)

	average number of inhabitants per branch		average number of inhabitants per employee[b]	average amount of deposits per employee[c]
	all financial institutions[a]	banks		
Belgium[d]	1.132	2.816	124	1.975
Germany	1.656	11.091	101	1.356
France	2.214	5.542	123	1.582
Netherlands	2.754	6.598	138	1.648
Italy	3.249	7.251	178	1.312
Spain	1.115	2.328	156	1.298
United Kingdom	2.792	3.956	106	1.470
Denmark	1.785	-	94	1.345

Source: Kredietbank (1990)

(a) post offices not included

(b) all financial institutions

(c) banks only; in 1000 ECU

(d) 1991

Table 4.

Profitability and solvency of the four largest banks

(in percent; average 1985-1991)

	(1)	(2)	(3)	(4)
Belgium	4.7	4.0	23.1	7.4
Netherlands[a]	5.2	4.1	13.1	9.5
Germany	5.7	3.4	24.8	8.3
France	3.2	2.5	15.8	8.9
United Kingdom	5.9	5.0	13.2	7.4
Sweden	8.2	5.1	17.1[b]	9.0[b]
Switzerland[a]	8.0	6.2	10.7	7.7

Source: Lierman (1992/b)

(1) equity / total debts
(2) equity / total balance
(3) profits before taxes / equity
(4) profits after taxes and depreciation / equity

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[a] average 1985-1990

[b] These figures are strongly influenced by the data for 1991. In this year profits before taxes were only 0,5 % of equity, whereas the ratio profits after taxes and depreciation / equity equaled -30.1 %.

Table 5.

Profit account of Belgian banks[a]

	1987	1988	1989	1990	1991	1992
Interest revenues	8.34	8.59	9.78	10.71	10.33	10.31
Interest costs	6.22	6.52	7.85	8.86	8.53	8.50
Interest margin	2.11	2.07	1.93	1.84	1.79	1.81
Results from foreign exchange trading	0.12	0.15	0.16	0.15	0.16	0.17
Results from securities trading	0.26	0.23	0.16	0.09	0.07	0.09
Revenues from services (fee income)	0.38	0.46	0.39	0.36	0.36	0.37
Revenues from participations	0.05	0.06	0.11	0.13	0.08	0.07
Total earnings	2.92	2.97	2.75	2.57	2.47	2.50
Operating costs and other costs	1.96	1.86	1.80	1.76	1.65	1.58
(personnel costs)	(1.35)	(1.33)	(1.30)	(1.27)	(1.19)	(1.12)
Gross profits	0.97	1.11	0.95	0.81	0.82	0.92
Corrections for value changes	0.55	0.60	0.50	0.41	0.46	0.55
Taxes	0.16	0.12	0.11	0.07	0.07	0.10
After-tax profits	0.26	0.39	0.33	0.33	0.29	0.27
After-tax profits (% of equity)	9.71	13.63	11.13	10.25	8.97	8.36

Source : Commissie voor Bank- en Financiewezen (previously Bankcommissie). Annual Reports.

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[a] banks with Belgian law statutes; % of assets

Table 6.

Profit account of Belgian savings banks[a]

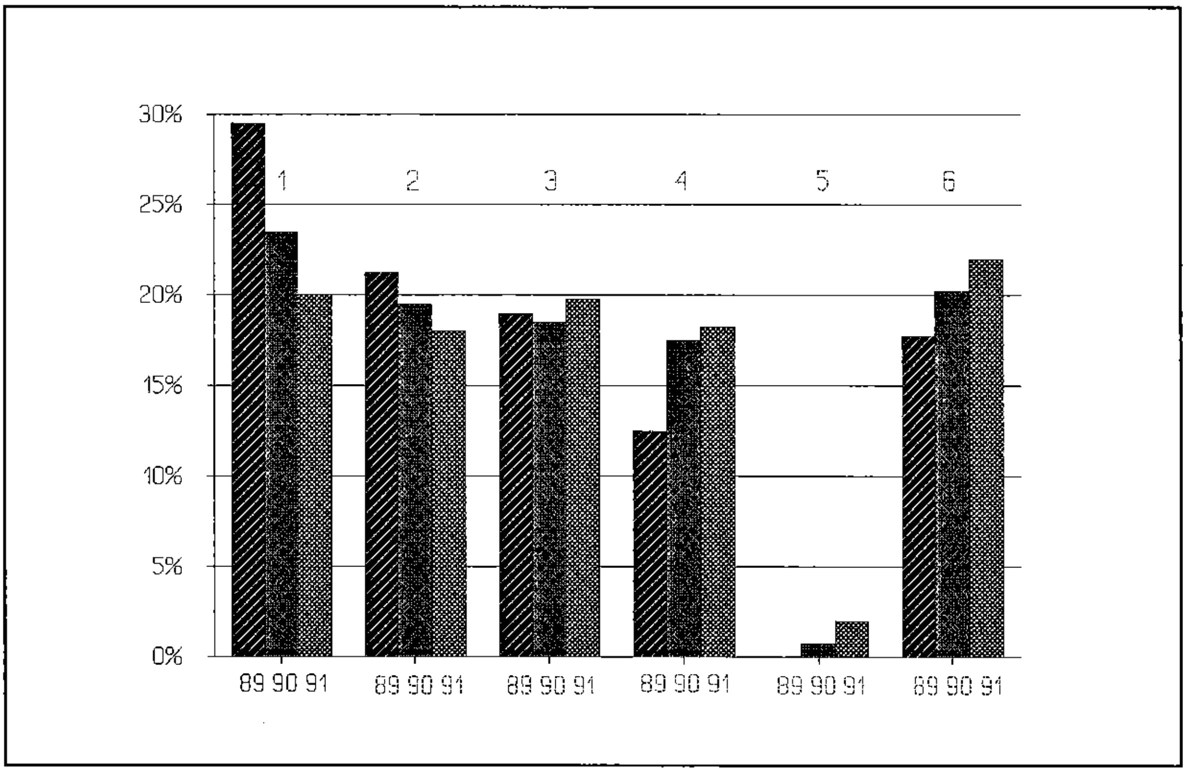
	1987	1988	1989	1990	1991	1992
Interest revenues	9.42	8.72	8.99	9.12	9.09	9.52
Interest costs	6.50	5.98	6.44	6.99	7.09	7.54
Interest margin	2.91	2.74	2.55	2.13	2.01	1.98
Results from foreign exchange trading	0.02	0.03	0.04	0.04	0.04	0.06
Results from securities trading	0.59	0.77	0.58	0.06	0.14	0.15
Revenues from provisions and services (fee income)	0.17	0.17	0.20	0.20	0.18	0.21
Revenues from participations	-	-	-	-	-	-
Total earnings	3.70	3.70	3.37	2.44	2.36	2.41
Operating costs and other costs	2.05	1.98	1.86	1.81	1.69	1.66
(personnel costs)	(1.08)	(1.02)	(0.97)	(0.96)	(0.91)	(0.87)
(fees paid)	(0.33)	(0.31)	(0.28)	(0.29)	(0.22)	(0.21)
Gross profits	1.64	1.72	1.51	0.62	0.68	0.76
Corrections for value changes	0.71	0.59	0.68	0.40	0.43	0.47
Exceptional profits	0.02	0.04	0.02	0.04	0.02	0
Taxes	0.18	0.12	0.05	0.04	0.05	0.05
After-tax profits	0.78	1.05	0.80	0.23	0.22	0.23
After-tax profits (% of equity)	20.97	21.37	16.64	4.86	5.17	5.75

Source : Commissie voor Bank- en Financiewezen (previously Bankcommissie) and Statistical Service, Belgium Savings Banks Association

[a] banks with Belgian law statutes; % of assets

Figure 1.

Share of various deposits in total deposits outstanding with Belgian banks[a]



Source : Commissie voor Bank- en Financiewezen (previously Bankcommissie). Annual Report 1991/1992.

1. tax-free passbook savings
2. sight deposits
3. time deposits < 30 days
4. time deposits > 30 days
5. savings deposits[b]
6. certificates of deposits

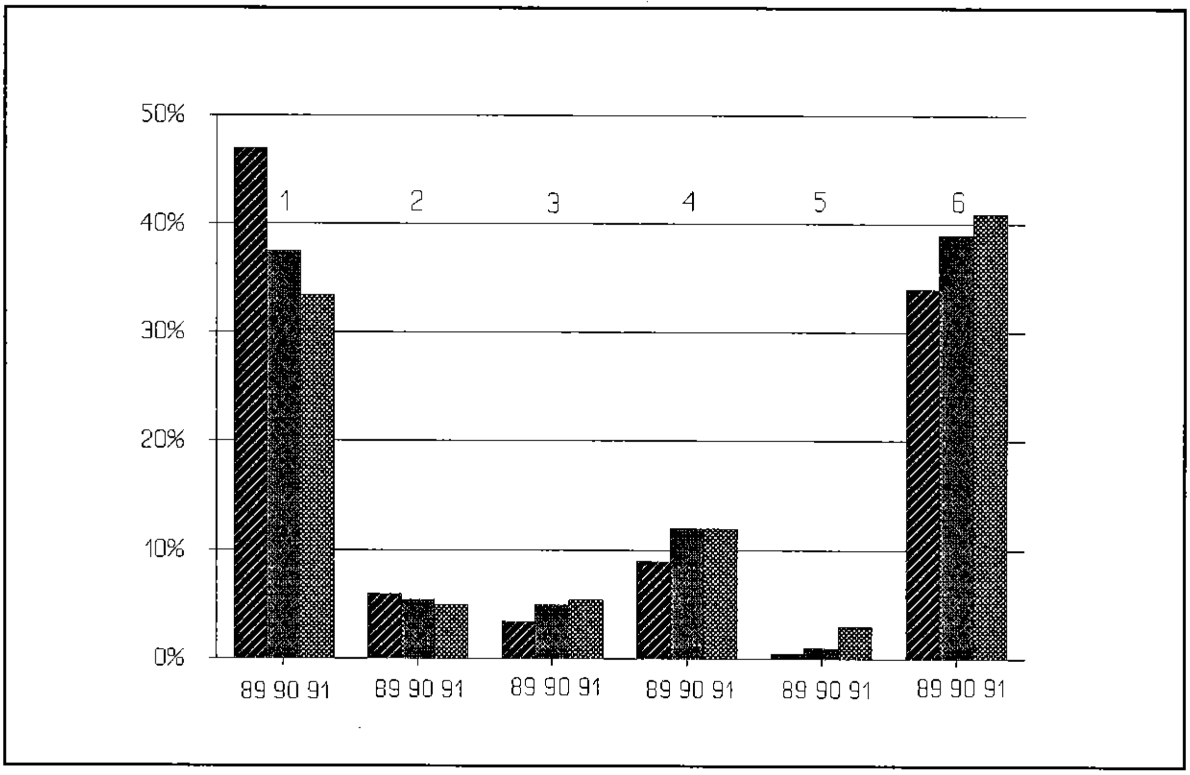
---

[a] only customers deposits in BEF

[b] without tax exemption

Figure 2.

Share of various deposits in total deposits outstanding with the Belgian savings banks[a]



Source : Commissie voor Bank- en Financiewezen (previously Bankcommissie). Annual Report 1991/1992.

1. tax-free passbook savings
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