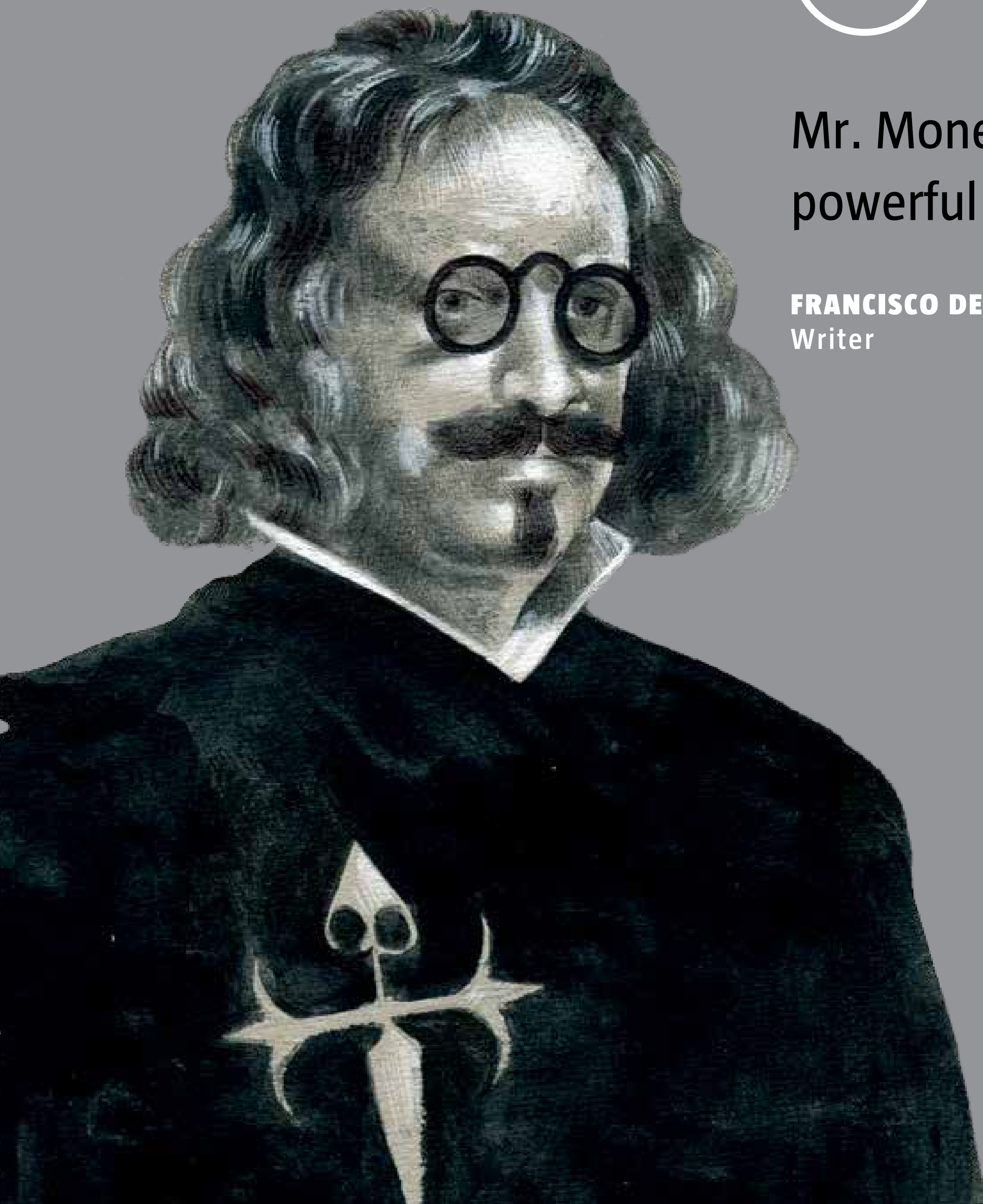
Mr. Money is a powerful gentleman

FRANCISCO DE QUEVEDO (1580–1645)
Writer



STRATEGY SPAIN

FINANCIAL SECTOR

09

FEWER BANKS, MORE COMPETITION?

Today, Spain's financial sector is the second most stable in Europe behind Estonia. Mergers and acquisitions have whittled Spain's original forty-five banking entities down to just fifteen. The sector has fewer players now, but it will have to be more open to competition in the future.

Relentless concentration

Bank mergers are being driven by low interest rates and bank regulators themselves. The move toward a European Single Financial Market will have serious repercussions over the medium term for the Spanish banking sector.

Íñigo de Barrón
Financial Correspondent at *El País*

"Spain is moving toward a banking oligopoly, if it isn't there already," says Robert Tornabell, Emeritus Professor at the Department of Economics, Finance, and Accounting of the business school ESADE and author of numerous books on the financial market. In his opinion, Spain could see the same turn of events as Italy in the 1990s, "when all savings bank business was absorbed by commercial banks." He forecasts a market in which everything will revolve around the three biggest and strongest banks in Spain by far: Santander, BBVA, and La Caixa. It is true to say that the Spanish market is suffering a hangover from the biggest financial crisis of the last seventy years. It is adapting to the final demise of savings banks in their original form, entities that at one point made up 50 percent of our financial system. Just a dozen such entities from the forty-five that existed before the onset of the crisis in 2009 will remain, although the surviving banks will be much bigger.

"The concentration of the Spanish banking sector has increased sharply due to the numerous mergers that have taken place, albeit in numbers below the European average. So there is room for this concentration to continue to rise," states Joaquín Maudos, Professor of the Fundamentals of Economic Analysis at the University of Valencia, Assistant Director of the research center IVIE and collaborator with the University College for Financial Studies (CUNEF). In fact, according to the most recent data, Santander, BBVA and CaixaBank account for 57 percent of the Spanish banking sector's total assets as of December 2014. In 2010, the same figure stood at 48 percent, evidence that the control of the country's banking assets lies increasingly in the hands of the three biggest banks. This rising share can be attributed to the acquisitions made by these entities, as well as the sale of the assets most badly affected by the crisis.

This is the general situation, but the perspective changes a great deal when we place certain regions of Spain under the microscope. Data from the National Competition Commission (Comisión Nacional de Competencia, CNC) reveals a worrying situation in provinces such as Ávila and Segovia, where a single banking entity has accumulated 60 to 70 percent of individual savings: this is the case of Bankia. Similarly, Abanca controls 50 to 60 percent of the market in Ourense and Pontevedra; Caixabank has a 50 percent share in certain regions following its acquisition of the Banka Cívica (comprising the former savings banks of Navarre, Burgos, Seville, and the Canary Islands); while Sabadell has also built up a significant market share following its takeover of the Alicante-based firm, CAM. Nevertheless, the CNC has not rejected these mergers because it only deals with the national and not the regional level when it comes to approving operations.

This challenge to competition was also the subject of a report entitled "Las Claves del Crédito Bancario tras la Crisis" (The Keys to Banking Credit Following the Crisis) published last year by the Spanish Confederation of Savings Banks (Confederación Española de Cajas de Ahorros, CECA). According to the report, twenty-seven of Spain's fifty-two provinces have entered the red zone of low competitiveness thanks to the merger, acquisition, and closure of branches and entities between 2008 and 2012. Moreover, it was considered that eight of these provinces (Cádiz, Almería, Guadalajara, Girona, Ourense, Huelva, Seville, and Santa Cruz de Tenerife) demonstrated "an extremely low level of competition." In contrast, banking markets in the regions of Valencia, Madrid, and some Andalusian provinces were those where the banks had to fight hardest to win clients.

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Inside Madrid's Stock Exchange

Despite this, since the flow of new credit began to increase slightly over the last six months, Spain has seen fierce competition over products such as mortgages. The big banks have fought for the best clients, reducing the prices of these products. That notwithstanding, there is no guarantee that once the credit market has stabilized along with the economy, the largest entities will not be able to impose their rule based on their enormous share of the market.

What the official data does tell us is that the banking sector continues its march toward concentration at a dizzying pace. And those in charge of Spanish banks have admitted as much in public. During one of the conferences organized by the auditor Deloitte in April 2013, the Director-General of the commercial arm of Banco Santander, Enrique García Candelas, explained that "we will only dispose of seven or eight banking institutions in the not-so-distant future. The trend for larger banks to absorb a larger share of the market is not over yet. Solvency and size will be key factors in deciding who will lead the sector. The level of concentration will mean that Santander, BBVA, and CaixaBank will take a 70 percent share of business."

The uproar this caused in the sector obliged the then-CEO of the entity, Alfredo Sáenz, to qualify these forecasts just a few days later, indicating that the three banks would in fact have a 50 percent share of the market in 2015. But we don't need to rely on statements from 2013. In April 2014, the Director of La Caixa, Isidre Fainé, was quoted in the *Financial Times* as saying, "I am like the cat waiting outside the mouse hole. Everything is possible. I think the Spanish banking market will simplify, just like the others. Now there are fourteen banks, and I think it will shrink to six or seven." These words revealed that Spain was well on the way to the oligopoly cited by Tornabell: if the three biggest banks could take 70 percent of the share then the five largest might account for over 80 percent of the market. This level of concentration would double precrisis figures. According to data published by the ECB measuring competition in each country's banking system, in 2007 the five largest Spanish entities shared 41 percent of the market. Increasing their share to 80 percent, a possibility raised by more than one banking entity, would leave Spain bringing up the rear in terms of European competition. At

Madrid's Stock Exchange, created in 1831, is one of the oldest financial institutions in Spain

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present, only Estonia, Lithuania, the Netherlands, and Finland have a lower level of concentration than Spain.

Technology has entered into the market concentration debate as a decisive factor. All bankers without exception have expressed their fear of the emergence of new technological competitors—which are not banks, these days—that might steal their share of the market. They are referring to certain start-ups or Internet giants such as Google, Facebook, and Amazon, as well as businesses such as PayPal or Lending Club. These operators, reluctant to call themselves banks in view of the strict legislation governing the sector, have nevertheless won the trust and goodwill of millions of customers. It is only a matter of time before technology gains complete access to the world of credit, savings and other products previously sold only by banks. As the CEO of Bankinter, María Dolores Dancausa, admitted on April 9, 2015, in a speech at a conference organized by Deloitte in Madrid, "technology has broken down the barriers to entry to the banking sector, which until now were its branches."

Can market concentration continue to rise? Bank mergers are being driven by low interest rates and banking regulators themselves. According to one of the greatest experts in financial analysis, Íñigo Vega, who works for the British firm Nau-Securities, "increased concentration will be influenced by the profits achieved by entities over the next two or three years. If they do not make profits in line with the demands of the market due to a lack of business volume—that is, due to the credit squeeze—or greater competition on the margins of the business, then it might be worth exploring higher levels of concentration with a view to achieving new cost synergies."

This will not only be a problem in terms of profitability. Íñigo Vega also indicates that there will be another channel for further concentration in the age-old way of accepting the defeat of a rival: by absorbing the entities that do not find a niche in the market, whether due to an inefficient business model, lack of scale, or poor management of risk. This was the main driving force behind the mergers that came at the end of the 1980s and 1990s in Spain, leading to the creation of today's Banco Santander and BBVA. When then-President of Santander, Emilio Botín, spoke at a meeting of that bank with Central Hispano on January 15, 1999, he claimed that this was the first transaction born of the arrival of the euro, the single currency that would supposedly break down borders and broaden business horizons. Botín stated that Santander would seek to be a bank with European dimensions. And this is another of the key questions: Is it necessary to increase the size of banking entities in order to compete in a new single banking market supervised by the ECB?

The fact is that a high number of mergers in recent years has significantly increased the size of banking groups, which now have average assets worth €95 billion. "In the case of savings banks, this more than triples precrisis levels. Within the banking union, it would be desirable for mergers to take place on a transnational level for the sake of competition. This type of cross-border transaction is more beneficial to financial integration because, among other things, it generates more competition on an international scale," Maudos explains. The expert reiterates that one of the lessons learned from the crisis is the importance of geographical diversification in reducing risk. This has been a key aspect helping Spain's two largest banks to resist the financial tsunami more successfully than its competitors.

CARLOS BENÍTEZ-DONOSO

Ciudad BBVA, the new headquarters of Grupo BBVA in Madrid

"The other banks should set their sights on the exterior market in order to grow in the future, just as Banco Sabadell has done recently with its offer to buy the British bank TSB," Maudos concludes.

But not everyone shares his opinion. Íñigo Vega believes that Spain's banking will be mainly retail in the future, "meaning that the European dimension will be less important. Spanish entities are the most efficient in Europe from a costs perspective. What has led them into foreign ventures has been their capacity for exporting and implementing cost control practices in inefficient entities. Therefore, the motivation for foreign activity is not necessity but the opportunity for banks to accumulate millions in margins, assets or credits while increasing their costs by very little."

The inexorable advance of the European Single Financial Market will have serious repercussions over the medium term for the Spanish banking sector. It is certain that the banks in the eurozone already operate with the same currency, and regulation and monitoring are just beginning to come together in a single system. But we are still missing a truly common European banking mechanism for winding up and liquidating entities. "Once this has been achieved, the eurozone market will be more comparable to that of the United States. Nevertheless, we must remember that, strictly speaking, the investment bank and large-scale commercial banking already operate in a single financial market," Vega says.

But retail banking is another dimension that will always have a strong local component, and does not necessarily need further concentration in order to seek stronger growth over the medium term. Let us return to the example of the United States, where banks with an important share of the market and operating in all states (JP Morgan Chase, Bank of America, etc.) coexist with regional banks that stick to certain states or specific areas, with solid and profitable branches. "The European market should be no different over the medium term," Vega concludes.

There is a great deal in play in this process of market concentration and the creation of large banking groups, since there is a risk of maintaining the strong trend for the "bankization" of the Spanish economy. The Chair of the National Securities Market Commission (Comisión Nacional de Valores), Elvira Rodríguez, stated on April 9, 2015, in Madrid that "in markets in which financial entities control credit, there is a poorer distribution and allocation among enterprises which hampers GDP growth." The government is going to try to provide enterprises, with open access to capital markets with new legislation in order to correct the weaknesses created by the great bankization process.

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Santiago
Carbó Valverde

Professor of Economics at Bangor University and collaborator with the think tank Funcas and University College for Financial Studies (CUNEF)

POINT

In favor of efficient operations

The most important question is whether the changes to the sector can improve the channeling of savings into investments and achieve the efficient financial intermediation that banks are presumed to provide.

Establishing the line between exogenous (external) determining factors and endogenous (internal) influences can sometimes be a complicated task. The case of the level of market concentration—measured as an accumulated market share—in an industry as crucial as the banking sector is a good example of this kind of confusion. On the one hand, corporate transactions that lead to a greater level of market consolidation may be induced by regulatory or supervisory decisions. On the other, the evolution of the business itself, of the competing forces and acquisitions or mergers privately agreed upon, can also bring about changes in the overall level of concentration.

The question of the potential effect of increased concentration is important insofar as banking institutions represent an essential mechanism for financing the real economy. It is vitally important that these institutions work efficiently within the parameters of fair competition. Concentration of the banking sector usually increases following periods of financial crisis. These increases often combine the effects of public and private initiatives, and aims concerned with restoring financial stability are intermixed with more strategic aims pertaining to the industry itself. Nevertheless, it also seems sensible to remind ourselves of the principle that there is generally some confusion surrounding the connotations of the term "concentration." Too often, greater concentration is understood to mean greater market power—or equally, less competition. Nevertheless, banking is precisely one of those sectors where it is perfectly feasible for only a few entities to exist, with a high level of concentration but also with strong competition between these entities. In contrast, it is also possible to have a sector made up of many smaller entities with a more reduced market share each in the form of an oligopoly of cartels with huge portions of market power.

The Spanish banking sector has undergone significant structural changes during recent years. The solvency issues deriving from the banking crisis have called for a reorganization of assets and changes designed to reestablish a more sustainable balance between supply and demand. The most visible impact of this action has been a diminishing number of entities, mainly due to mergers. The set of entities most affected by this trend were savings banks. Of a total of forty-five building societies that existed before the crisis, forty-three have taken part in one consolidation process or another, with a resulting total of eleven banking groups today; that is, a quarter of those that existed prior to 2008. As a consequence, the average value of such entities increased to €29.4 billion in 2009 and €91.5 billion in 2014.

In comparison with other European countries, Spain's restructuring has been more intense. Savings banks alone have closed 8,494 branches between 2009 and 2014, losing some 36.7 percent of their network. Banking staff were reduced by 41,391 for the same period, a drop of 33.4 percent. Examining the sector as a whole (commercial banks savings banks, and credit cooperatives), branch closures are estimated to reach 20 percent in Spain, while in other countries such as Germany or the United Kingdom the branch closure rate stands at 5 percent and 3 percent respectively. Another striking comparative figure shows that in many European countries where cutbacks to the network of branches have been conservative, staff cuts have nevertheless been considerable. This is the case of Germany, for example (-26,450 employees between 2008 and 2013), Italy (-28,495) and the United Kingdom (-54,225). This suggests that banks in other European countries have been reluctant to undertake a true restructuring process, mainly transferring the costs of cutbacks to employees, with scant correction in terms of offer or physical infrastructure.

In any case, despite decreasing numbers of competitors, it cannot be said that Spain has seen a dramatic increase in concentration. The main reason for this is that banking markets are essentially provincial by nature, so although the number of operators may fall, market shares may essentially remain well distributed. Between 2008 and 2013, the Herfindahl-Hirschman Index (HHI)—which measures the sum of the squares of the market shares for all operators and sets them on an index from 0 to 1—has barely moved from 0.12 to 0.15 between 2008 and 2014. This means that concentration has remained at a low level when analyzed on a provincial scale—which is the relevant level, from a business point of view. In keeping with the results achieved in industrial organization during recent decades, we can say that there are forces as or more important than concentration that explain levels of competition in Spain. In particular, more important than whether there is a small or large number of entities is the intensity of competition between them, the capacity of some institutions to enter their rivals' markets, the so-called market contestability. This is why a large proportion of academic analyzes concerning Spain conclude that competition has not diminished; on the contrary, it has risen, as evidenced by narrowing margins and competitiveness in price segments such as savings or credit—even in the last few years.

In short, not only is it important to establish whether the forces that can drive a restructuring—with the likely consequence of greater market concentration—are endogenous or exogenous: the most important question a priori is whether these changes can improve the channeling of savings into investments and the efficiency of the financial intermediation that banks are presumed to provide. Various factors suggest that changes to the banking structure in Spain in recent years have been positive. First of all, as indicated above, it simply does not seem that the intensity of competition has diminished. Second, this transformation has helped restore confidence in the Spanish financial system. Third, in a global market where access to liquidity can be complex and costly for small institutions, the increase in the average size of Spanish banks has favored their presence on these financial circuits. Moreover, the rising average size has led to significant gains in efficiency and economies of scale, as well as improved profits, according to recent studies. The main conclusion we can draw from all of this for the purposes of economic policy is that concentration can be positive if it yields efficiency and maintains the intensity of competition. That said, in our present situation it is also advisable that we recognize that there is less of a margin now for new mergers, and that once a period of financial instability is over it is worth assessing any additional movements in terms of competition.

A final significant issue to take into account is what happens to SME financing mechanisms traditionally linked to specific regions when many local and regional entities have been absorbed by national banking groups. In this respect, the benefits of this "relationship banking" can be transferred to these new, consolidated entities if they are capable of continuing to exploit the informative benefits of such regional relationships while favoring local financing, taking advantage of their access to liquidity circuits (both internal and external) broader than those available to each entity on a separate basis. In any case, given their success in the past, policies that foster links and relationship banking should be welcomed in a country where this model has represented a paradigm of success in retail banking over many years.

COUNTERPOINT

Miguel Ángel Fernández Ordóñez

Ex-Governor of the Bank of Spain

In Europe and in Spain

Spain must continue to advocate a more equal treatment of all financial institutions, whatever their nationality and the country in which they operate.

Banking regulation and supervision have a significant international aspect. Before the crisis, the Basel Committee already provided an interesting example of "soft law" instruments used as a response to the financial globalization that skyrocketed at the end of the last century. But the creation by the G-20 of the Financial Stability Board (FSB), the body in charge of managing regulation changes implemented in recent years, has only served to further reinforce the global dimension of such projects.

Spain must continue to contribute to the collective task of ensuring a more equal treatment of all financial institutions, whatever their nationality and the country in which they operate. In this sense, our country should continue to make use of the experience offered by the Bank of Spain thanks to its significant role in these bodies, both in chairing the Committee of European Banking Supervisors (CEBS) that was the original nucleus of today's European Banking Authority, and in the Basel Committee, as well as its participation in the Executive Committee of the FSB following the crisis.

In Europe, regulatory and supervisory tasks have become an even more multinational task not only because it traditionally falls to Europe to convert FSB recommendations into Directives and Regulations (the Single Rulebook), but also due to the construction of that new EU initiative known as the Banking Union. Spain should contribute to this undertaking without any pretensions of gaining national exceptions or privileges, which always jeopardize others—including the parties that manage to obtain them.

But there are other tasks to be performed within Spain by the nation's authorities and banks.

Independence from the FOBR

We should begin by making a U-turn in the politicization of some areas of monitoring and the divestment of functions inflicted on the Bank of Spain in recent years. In particular, the Fund for Orderly Bank Restructuring (FOBR) needs to revert to the institutional design that it had at its creation, handing back the management of the resolution of banking entities to the Bank of Spain, and leaving in the hands of the government the power to veto Bank of Spain proposals in the event that better alternatives exist for taxpayers – something which, incidentally, has never happened. To this end, and following the example of the majority of European Union countries, the FOBR needs to be depoliticized and cease to depend on the Ministry of Economy and Finance.

With a view to reinforcing autonomous supervisory capacities and reducing the politicization of such functions, the Draft Law submitted by the Bank of Spain to the government concerning the reorganization of the institutions supervising financial entities should be taken up once again. This proposal suggests bringing together all matters concerning bank solvency in the Bank of Spain, while the Securities and Exchange Commission would deal with protecting investors and consumers. This would bring down the current politicization of securities supervision, which still depends on the Ministry of Economy and Finance, while the Bank of Spain would be responsible for supervising the solvency of all financial institutions, at a time when innovation and regulatory arbitrage is leading traditional banking tasks to be carried out by other entities.

Ensuring competition

In order to ensure that entities can work in a more efficient way, it is also important to pay attention to the competition framework in which they operate. It is likely that if Spanish credits institutions were more efficient and innovative than those in other countries in the past, this was largely due to the competitive environment in which banking activity was performed in Spain. Nevertheless, the way the crisis was managed has led to a substantial increase in banking market concentration in our country. But such concentration was inevitable. Although some people wanted to ignore the fact, mergers (whether agreed or by amalgamation) are not only the least costly way for the public purse to resolve banking crises; they also facilitate a stable transition of service provision since mergers maintain the relationships between enterprises and households. Notwithstanding, and albeit with no urgency (overcapacity can be helpful to begin with), this greater concentration must not be allowed to stifle competition. To this end, rather than adopting a stance against larger entities—the advantages of economies of scale are obvious in this business—other mechanisms should be used that can increase competition in national markets without choking growth in terms of size on a global level.

Completing the depoliticization of banking entities

Spain must complete the process of depoliticizing banking entities themselves. The crisis suffered by many savings banks has clearly highlighted the dangers of financial entities depending on politicians. While the most significant and well-known examples of this problem concern the Autonomous Regions of Madrid and Valencia, mistakes have also been made in other regions and under the rule of other parties: it cannot be said that the politicization of savings banks was a problem affecting one party alone. It is true to say that the government in power from 2008 to 2011 took an important step in establishing initiatives that worked adequately to convert building societies into banks. This had a very positive impact, reducing the powers of autonomous regional governments, who in some cases had used their powers to prevent interregional mergers, solely permitting those involving entities within their region (and the latter were more inefficient and expensive for taxpayers). But both those reforms and later reforms approved by the current government will be insufficient in the future because no action has been taken to prevent credit entities from depending on political institutions. This is why it is crucial that institutions with a political vein must be obliged to transfer the portion of their assets invested in credit institutions to nonfinancial sectors within reasonable deadlines, as suggested by the Bank of Spain in April 2012 and set out in the memorandum of understanding concerning the rescue package. Over the short term, this might feel like a "punishment" to those who have done a better job of managing savings banks that did not create problems and in fact even assisted in resolving them. But if we take the long view, it is clear that we cannot guarantee that any political changes that might take place in the future will not lead to the disastrous consequences of mixing politics with credit entities that we suffered during the crisis. It is true that governance in trading companies is never perfect. Many problems exist in this sphere, but the Spanish experience has shown that the kind of model described above is less negative for society than deliberate and tutored governance by politicians, as took place in Spain's Autonomous Regions.

More non-banking finance for enterprises

Finally, Spain has still essentially made no progress whatsoever on increasing the weight of non-banking financing for Spanish enterprises, in particular in the case of medium-sized enterprises (large companies have no problem accessing finance). Europe is very behind in this matter compared to the United States, and Spain is even further behind when compared to Europe. The recent European Commission initiative to advance the Capital Market Union (CMU) is an opportunity that we must not pass on if we want to cooperate with other countries in the way suggested above.

TALK ABOUT THE FUTURE

José Sevilla

CEO of Bankia

Should the banking market in Spain become even more concentrated?
Spain has made very significant efforts in terms of concentration. From the year 2008 until today, we have gone from fifty-four financial entities to fifteen, and this has happened alongside great efforts to reduce costs. Approximately 30 percent of bank branches have closed over the last six years, and banking staff numbers have also been reduced in a similar proportion. So the Spanish financial system has done what it had to do. But it is true to say that we are now in a new environment, that of the European banking union, which is characterized by extremely low—extraordinarily low—interest rates. In this context, the challenge for all banking entities is to achieve acceptable levels of profitability. In this environment, banks and financial institutions in general face a greater concentration, which will allow them to achieve new cost savings and ultimately shape a more efficient banking system.

How can competition be guaranteed with fewer banks?
In the United Kingdom, there has been a concentration process that has left the country with four main players. But there is still a decent level of competition. In Spain, the concentration process we have experienced in recent years has really had no effect on competition whatsoever. This is due to a series of reasons: today, Spaniards have the cheapest mortgages in the whole of Europe when compared to the Germans, French, and Italians. This ultimately underlines the process of competition that we have in the Spanish financial system. So I don't believe that further concentration will necessarily lead to less competition.

Can there be a European banking union without pan-European banks?
I am convinced that over the medium term, over the next three years, we will probably see some pan-European banks being founded.

Do we need to reduce the excessive bankization of enterprises, currently at 90 percent?
The model of financing that we have in continental Europe is different to that of the Anglo-Saxon world, but it will change over time. European entities are interested in fostering the development of capital markets and in ensuring that companies can access them as a complementary option to bank finance. Banks themselves are also interested in ensuring this process happens because it has advantages for banks, given that it will introduce market discipline. It is a healthy process and banks should not obstruct it; on the contrary, we should encourage it.

How can venture capital be encouraged in this country, given that it is so essential to innovation and entrepreneurship?
In general, the answer has always been to go down the route of giving tax breaks to venture capital. But I do not think that this is the solution over the medium and long term. Businesspeople have to accept that an increasingly large proportion of their financing will have to come from capital markets, and venture capital is probably a first step toward helping smaller businesses grow and obtain alternative finance to complement bank financing. During the last two years, we have seen an increase in investment from foreign sources in general, in the form of private equities and other kinds of funds, which signals the route we will go down. There have also been initiatives from the state working through the ICO, the state-owned bank, with the launch of funds to be incorporated into venture capital companies. It is going to be a slow process.

> "The Spanish financial system has done what it had to do, but it now faces greater market concentration"

Enrique Tellado

CEO of EVO Banco

> "Compared with mortgages, other banking businesses have always been subject to very low risk and very high profits, as in the case of bank cards or consumer finance"

Are you optimistic about the Spanish economic situation?
It's improving but I am still a little skeptical. One way of measuring the improvement is by looking at the level of employment, which is unlikely to be at the levels shown by official unemployment figures but neither is it likely to be where it should. Another way of measuring it is based on average consumer confidence and the mood among the population, which is currently cautious. We are seeing more saving and less consumption than we would want. When we manage to reduce these barriers, we will be able to claim that the economy is really going well. We will manage it.

Should there be even more concentration of the banking market in Spain?
From the perspective of our customers, it is not necessary and wouldn't be a good thing. From the point of view of our financial entities' income statements, it could bring improvements. I imagine that concentration will take place, because with such low interest rates in the financial market margins are very tight, and concentration provides a potential solution that might ensure the survival of enterprises that are at risk. Moreover, the sector's model needs substantial restructuring. It isn't necessary to follow a model based on having thirty-five thousand branches when customers need to visit them less and less.

What do you think of the prospects for a capital markets union in the EU?
The main risk is that it won't be done properly. Ultimately, it's a case of more haste, less speed: the big decisions have to be really well thought over, and the options for creating and undoing this work have to be analyzed very thoroughly. That said, the broader and more transparent the markets are, and the greater the access to capital (no matter where it comes from), the better the impact on economic growth.

What is the banking business like when interest rates are so low?
Difficult or exciting, depending on your perspective. Success depends on being capable of providing products that offer customers an alternative and involve very limited production costs so that these costs do not have to be passed on in the form of commissions: it has to be possible to work with the prices and offer made. In Spain, banks have competed a great deal in the very traditional market of mortgages. Compared with mortgages, other banking businesses have always enjoyed very high profits, as in the case of bank cards or consumer finance, with very low risk. The default rates of 3 to 4 percent sustained by banks in consumer financing are not good enough.

How can Spain encourage venture capital?
When we can manage to understand that some entities very much need to be financed to a level of 15 or 20 percent at some point because it will allow them to grow and develop in a spectacular way, or at least avoid a very complicated system, venture capital, private equity, will evolve in the right way. Venture capital solves very complex problems where banks don't want to get involved and businesspeople need somebody to support them. It isn't just a question of providing finance: it also helps solve the problem with experience in facing complicated situations. It is help that might be considered expensive—but it probably isn't.

TALK ABOUT THE FUTURE

Miguel Artola

Director of Asset Management, Bankinter

Is bankization of the Spanish economy excessive at 90 percent when compared with other countries, where the norm is around 70 percent?
The level of bankization is very high in continental Europe in general, so this isn't something exclusive to Spain. It is a fact that banks are the main mechanism for channeling investor savings, and the size of our economies has a lot to do with that. In the most developed economies such as the United States, which has a greater critical mass, other mechanisms are possible. There is no immediate solution.

Are investment funds the only alternative for financing for many enterprises?
The problem is that, due to its design, the investment fund is a vehicle that has to have a great deal of liquidity. This goes against long-term business financing, above all in the case of vehicles that don't have liquidity. There should be vehicles that specialize more in business financing. They don't exist in Spain, but you do find them in more developed economies such as the United States.

Is venture capital underdeveloped in Spain?
Yes, it is underdeveloped. There is also an issue to do with size. One of the fundamental factors is the creation of a single European capital market to build critical mass, ensuring that there is enough money to invest in it.

Do we need to promote the now anemic alternative fixed-income markets such as the MARF and the MAB?
The alternative markets have had a great deal of success in the United States and the United Kingdom, but once again they have been more limited in continental Europe, mainly because of this lack of large investors. The fact that there aren't sufficient savings in financial capital in Spain and in continental Europe to be able to meet this kind of demand is an endemic problem. A tax system more favorable toward pensions would be very useful in the sense that investment in pensions is by definition long term, which would make it easier to be able to take on this kind of risk and lack of liquidity.

What challenges and opportunities does the creation of a single capital market in Europe pose for your sector?
Given that this would lead to much more integrated financial markets, the creation of a European single capital market would be an enormous advantage in terms of liquidity, size, and synergies. The challenge would be competition. Each country's management entity has some very clear advantages in their own country, but they would have to be capable of competing with large international entities on the European level.

Can an economic and monetary union be built in Europe without pan-European banks?
No. But we should go slowly. It is clear that we need pan-European banks in order to fully integrate capital markets.

Has technology done away with barriers to entry in the banking sector?
When it comes to everything related to payment methods, some very powerful competitors have emerged on the Internet, and clearly that's a space where there is already a great deal of competition. In contrast, in other activities such as the allocation of credit, it is very rare for people without the sufficient experience to be able to compete. In this case, experience is extremely important and, in principle, this barrier cannot be broken down with technology alone, even though technology has almost limitless potential.

> "There should be vehicles that specialize more in business financing. They don't exist in Spain, but you do find them in more developed economies such as the United States"

Almudena Román

Director-General of ING Direct

Is there still excessive bankization in Spain?
In Spain we are going to have to continue to create vehicles facilitating more access to financing for entrepreneurs for some years, not as a means of investing in capital but as a way of solving working capital issues and long-term needs in companies. Banks are going to continue to have a key role, simply because we are the only ones that have that banking license that imposes a lot of obligations on us but also allows us to safeguard our customers' savings. Often, when you look at where all this financing is going, what it is spent on crowd-funding initiatives, or in venture capital initiatives and everything that we are seeing in terms of fundraising, you can see that it's all risk capital. Yes, it is true that in Spain we are starting to see vehicles that are more clearly geared toward generating capital for new enterprises, and we have to keep working to create them. Banks are key players in this, and we are capable of immediately channeling funds in this direction, but this is just starting to happen now.

Since the crisis, do people think more in the long term in the banking world?
The measures that have been taken in countries have varied depending on the pressure that has been exerted within the society in question. In Holland, for example, bankers now sign a code of conduct that deals with personal liability. Meanwhile, there are other bodies working via the European Central Bank. Work is being done to standardize the banking sphere to a certain extent. Reputation management—I call this "authenticity"—is a proactive tool that we have to make use of in banking.

What does a European Capital Markets Union mean to you?
If we can come together and work together as a single market, we will be able to give European citizens opportunities in the form of the world's third-largest market. And what would that offer? To put it simply, it would offer more efficiency, more harmonization, and more ease of operation. European banks have to work with a great many regulators all at once. For example, at ING we work with thirteen regulators, and this means that there are a great many barriers to harmonization, standardization, and unification. This means less efficiency and less clarity for European businesses and consumers.

How is digitalization changing the sector?
The banking business is pure software now. It isn't so much that it is changing the sector; rather, we have entered a new era. That is to say, it's a different production cycle. Digitalization means that we share this new territory—software—with a whole collection of other industries, and this forces us to ensure that customers have a very similar experience in very different spaces. We have to think in a different way and learn from this new place. And anything that comes from a previous age is probably a hindrance when it comes to taking advantage of everything that is coming in the future. Digitalization means transferring power from the bank to the customer. This requires reorganization, simplification, and a huge increase in transparency and immediacy in all of the services we provide. In ten years' time all banks will be digital platforms. ING customers in Spain can do everything they want to do online, and about 20 percent of our customers exclusively use the website. And I'm not talking about the mobile channel but mobile phones. That is happening today, in Spain.

> "Digitalization means transferring power from the bank to the customer"