Talking point

European banks' foreign revenues: Europe gaining ground

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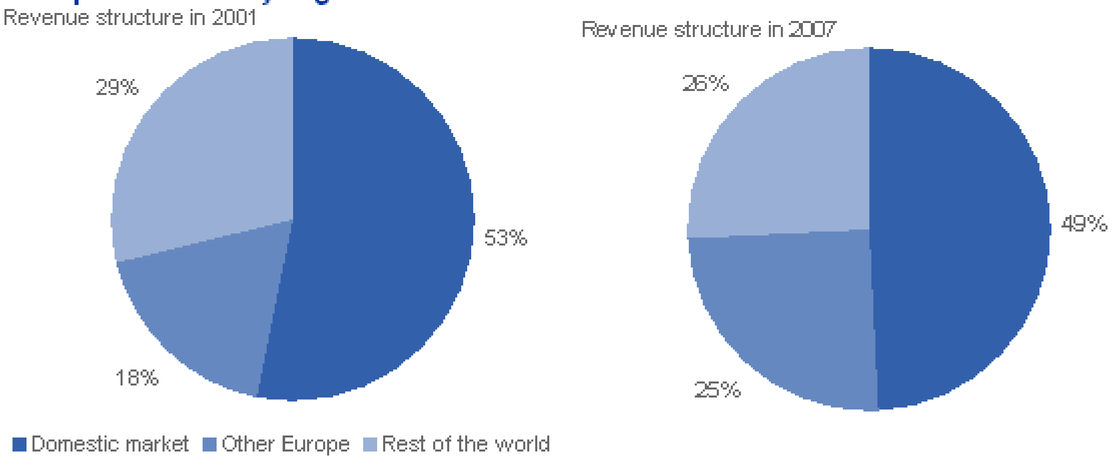
European banks have become considerably more international over the past few years, in terms of both the structure of their revenues and of their shareholders. In this context particular emphasis has been placed on strengthening the European business outside the home market, with the home market share in total revenues falling as a result – at the 20 largest European banks e.g. by 4 percentage points since 2001 to less than half. By contrast, as much as one-quarter of total revenues came from the rest of Europe in 2007 (2001: 18%).

Major drivers of this development were the numerous cross-border mergers and acquisitions which are reflected in the figures for direct investments of European banks within the EU-15: FDI rose from EUR 17 bn in 2002 to EUR 31 bn in 2005 (latest data available). The ongoing rise in the volume of cross-border M&A transactions in Europe suggests this trend has probably continued in the recent past: in 2007 the volume reached a record EUR 112 bn in the banking sector, with EUR 70 bn stemming from the takeover of ABN Amro alone.

From the banks' point of view, there are manifold reasons to look abroad: especially Europe's largest banks are faced with largely saturated and often highly concentrated home markets with limited potential for organic growth. At the same time, international expansion offers numerous opportunities to diversify revenues and risk, tap growth potential and realise economies of scale.

Revenues of the 20 largest European banks by region



Sources: Company reports, DB Research

The particular attractiveness of the European market is attributable to several factors: for one thing a large, developed and stable market beckons which nonetheless offers growth potential thanks to diverging macroeconomic performance and differing market structures. For another, the emergence of a single financial market with a unified regulatory framework and mutual recognition of concrete legal provisions is facilitating cross-border banking business.

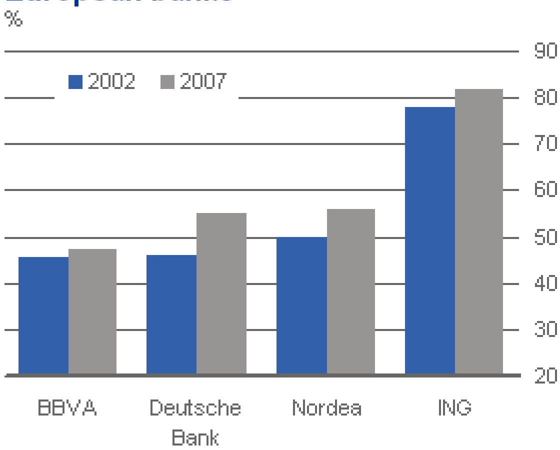
Likewise, however, the emerging markets of Central and Eastern Europe, Asia and Latin America have become attractive investment targets for European banks over the last few years thanks to their opening toward the market economy, their strong growth, ever more intensive integration into the world economy and a favourable demographic outlook. However, the slight decline in the share of revenues generated outside Europe reflects the fact that the mostly small size of the financial systems in these countries (still) limits their overall significance for European banks' revenues.

Last year's subprime crisis exacerbated the effect of a moderately lower share of business generated outside Europe as especially the large European banks that are active in investment banking had to write down exposures to US mortgage bonds and leveraged loans to hedge funds and private equity firms. Due to these write-downs, which were mostly booked in the North American financial centres, (trading) revenues from outside Europe declined. Moreover, there are large domestic mergers among banks in Europe to be considered for the year 2007, which had a positive impact on the domestic market share in total revenues. In both cases, however, these are mostly one-off effects which will not be able to stop the long-term trend of increasing internationalisation and, in particular, "Europeanisation" – and definitely not against the backdrop of the process of national consolidation now almost complete in many countries.

Irrespective of this general trend considerable differences remain among the 20 largest European banks: while some already generate more than two-thirds of their revenues abroad, others are still focused almost entirely on their domestic market. The different degree to which banks are active abroad can be attributed to their strategic focus, which may be based – among other things – on banks' tradition and history, the international know-how they have already acquired and the conditions in their home market which in turn are shaped by the size of the market, the degree of consolidation and the entry barriers for foreign competitors.

At the same time, but not to the same extent as the structure of revenues, shareholder structures of European banks, too, have become increasingly international over the past few years. This is due, for one thing, to M&A activity abroad financed with banks' own shares, and for another, to the active search on the part of banks for large shareholders and the rising interest of international institutional investors in a broader diversification of their portfolios. Finally, the appeal to overseas investors of the introduction of the euro and European financial market integration also should not be underestimated.

Foreign share ownership, selected European banks



Sources: Company reports, DB Research

Overall, the trend towards geographically broader revenue structures and a more diversified and more international shareholder base of European banks will probably persist in the years to come. There are good reasons – not least the enormous growth potential outside the banks' home markets which are already relatively consolidated and highly competitive, as a single market for financial services in the EU is becoming more and more attractive also for non-European banks. Despite investors' often cited home bias, shareholder structures, too, will probably see a larger proportion of foreigners in future, who can thus diversify their portfolios more efficiently while the banks benefit from a more balanced distribution of their shareholders.

For more information please see:

European banks: The silent (r)evolution

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Jan Schildbach (+49) 69 910-31717
Ulrich Hendel

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