

Banking Mergers

Transactions costs and market definition

The definition of banking markets has to date been straightforward but the diversity of services and continuing technological changes is making competition analysis increasingly difficult. Here several of the issues raised by mergers among retail banks are examined.

Nature of EU banking consolidation

Once exempt from competition law, banking is now subject to increasing scrutiny by the EU Commission, and national competition regulators. The European banking sector is consolidating. Some of the largest banks in France (BNP, Paribas, Societ  Generale) and Italy (San Paolo-IMI and Banca di Roma; Unicredito and Comit) have announced plans to merge. Notwithstanding this, European retail banking remains relatively fragmented and national in character. Most consolidation has taken place between banks within a single Member State, and therefore has not triggered EU merger control.

Products or Clusters

The EU Commission has so far cleared all banking mergers. In so doing it has adopted a common sense, product based approach to market definition. However, it has noted that this may not always be appropriate. In *Fortis/CGER* (1993) the Commission stated:

“Each banking product is distinct, but the degree of substitutability between different products is difficult to appreciate. There is no substitutability between certain banking product groups but the division between others are far less clear. Banks do not generally offer only one type of account or loan so there are strong linkages between the different product groups within the retail banking sector.”

As the Commission noted, banks rarely offer their customers one service or product. They offer current and savings accounts, loans, mortgages, insurance, pensions, sharedealing and so on. Moreover, consumers often purchase all of their banking products from the same bank.

This has suggested to some regulators the possibility that a bundle of products jointly consumed by customers may define a relevant market for merger analysis. In the US the concept of a cluster market has been developed to capture this idea. First used in *Philadelphia National Bank* (1964), it has subsequently been applied in antitrust cases concerning banking and hospital care services. The

Federal Reserve Board (FRB) and the Office of the Comptroller of the Currency, which have jurisdiction over banking mergers in the US, routinely use cluster market analysis. In contrast the US Department of Justice prefers the standard approach of identifying markets by individual products e.g. loans or credit cards.

When does a cluster market exist?

Cluster markets are said to arise because of “transactional complementarity” i.e. the cost-savings of one stop shopping for services. Consumers in a cluster market realise savings from aggregating the consumption of a number of services into one package. Therefore, the consumer would face substantial transaction or “hassle” costs in unbundling two or more services. As a result the consumer “buys” a package of services/products, and evaluates the package price and quality rather than its component parts. If customers found it inconvenient to have current accounts, saving accounts and credit cards with different banks and the majority bought such services as a bundle, then they would form a cluster.

Clearly the existence or otherwise of a cluster market is an empirical matter, and there are some who doubt its existence at all. Notwithstanding this, it is apparent in practice and in the arguments advanced in competition cases that firms which offer bundled services are seen as more attractive to consumers and regarded as having a competitive advantage to those offering a more limited array.

For a cluster market to exist it would appear that a number of conditions must be satisfied. If consumers (a) face substantial transaction costs in having more than one banking relation; (b) these unbundling costs are large in relation to the cost of the cluster; and (c) the demand for one component of the cluster depends on the price of the “whole cluster of products” and not necessarily on its own price, then products are likely to form a cluster market. Similarly, if banks offer and sell their services on the basis of an overall price, examining the market in terms of product cluster should be pursued.

The above can be re-cast in the more familiar terms of EU market definition. In a particular merger case a cluster market would exist if the hypothetical monopolist of bundled products were able to raise the price of the cluster without consumers switching their purchases to firms that supply individual products or services in the

cluster. This would define the market as only those firms supplying the range of products in the cluster.

Supply-side Issues

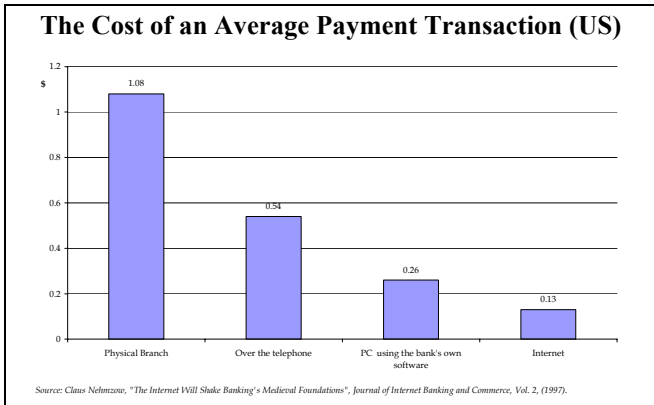
Traditionally, people have tended to bank at branches located near where they work and live. This has meant that retail banking markets are local rather than national or pan-national. However, the advent of electronic banking will increasingly alter the structure and geographical nature of banking. The growth of Automated Teller Machines (ATMs) was the first step, and this will accelerate as personal computer and Internet penetration increases.

constraints on the merging parties. As the EU Commission observed in *Fortis AG/General Bank* (1998):

“even if the new entity will have the strongest market network in Belgium, this will not confer on it a dominant position since consumers will have sufficient competitors’ banking outlets at hand. Furthermore, the existence of cash dispensers, electronic banking and telephone banking minimise the effect of any strong position in this respect”

	1985	1990	1995	1996	1997
Credit Institutions	12,256	11,957	9,896	9,598	9,285
Branches per 1000 capita	0.52	0.51	0.49	0.48	0.48
ATM per 1000 capita	0.10	0.20	0.36	0.40	0.44

Number of credit institutions: UK is not included in 1985, 1990. Figures for branches and ATMs are calculated as unweighted EU averages.
Source: ECB, "Possible Effects of EMU on the EU Banking System in the Medium to Long Term", February 1999, p. 15.



Electronic banking substantially reduces the transaction costs and barriers to entry to retail banking. The cost of banking based on new technologies has been estimated at four to 10 times lower than traditional “brick branch” banking. This means that potential competition from new and foreign entrants will increasingly play a part in market definition even though they may not be located in the same area or even Member State. New retail banks will be able to enter with a limited or no branch presence by using telecommunications networks. The recent success of Egg, the direct banking arm of Prudential in the UK, using telephone and Internet is a case in point. Egg met its five-year target of £5 billion of new savings and 500,000 customers in just six months!

Conclusions

Antitrust authorities are generally sceptical about the use of transaction costs analysis. As used to provide the underpinning for cluster markets and potential competition it is regarded as a defendant’s concept designed to widen the market, lower the market share and therefore avoid merger control. However, in banking the impact of transaction costs considerations is more complex. Cluster analysis may serve to limit market power on a specific product basis while e-banking may lead to “unbundling” because the transactional costs of customers switching suppliers on a product by product basis become negligible.

These supply-side developments will play an increasing role in retail banking and affect merger analysis. This may not occur at the market definition stage, as these supply-side adjustments may not be as rapid as the ability of customers to electronically switch between banks, but certainly at stage two in assessing the competitive

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