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# **Trends and Developments in the European Financial Sector**

*Eleftherios THALASSINOS\**

## **1 The Structural Change in the National Banking Markets**

At national level, financial institutions respond to the new European environment with mergers, acquisitions or even alliances, which are drawn in order to solidify their market position and to resist new competitive pressures from abroad. Two are the main tendencies that coexist. The first refers to mergers and acquisitions that create powerful financial groups capable of competing at a national level. The second focuses on strengthening the role of smaller, contemporary and flexible banks with specialised production and a spectrum of innovatory products and services, and on interconnecting their network with sizeable financial units.

The exploitation of economies of scale and economies of scope appears to be the fundamental objective of such activities (Berger – Demsetz – Strahan, 1999). Generally speaking the economies of scale are presented in national level due to the capability of firms to allocate fixed cost such as clerical operations, research and cost of calculations to a great variety of products. There are also important occasions of financing economies of scale. A large number of customers decreases the uncertainty of undertaking deposits and consequently decreases the need for retaining liquid assets. Moreover, the bankruptcy of sizeable financial companies is not acceptable since this would lead to a mass withdrawal of capital and to a general financial panic that could undermine the stability of the entire financial system.

The fact that size constitutes a competitive advantage is recognized not only by institutions, but also by national authorities, which do not

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prevent, but on the contrary, encourage mergers and acquisitions between domestic financial institutions.

For example, the Italian authorities changed their policy and allowed mergers (Cassa di Risparmio and Banco di Roma) with the view not only to rationalise the sector, but also to protect Italian banks against the danger of becoming easy acquisition targets by foreign competitors. The merger between the two leading Dutch banks the Amsterdam Rotterdam Bank (AMRO) and the Algemene Bank Nederland (ABN) in 1990, was considered to be a defensive decision, which was developed in order to prevent the acquisition of both of the two associates from foreign companies. The Central Bank of Holland encouraged the merger despite the fact that it led the Dutch banking sector to a great rally, since the new institution controlled 25% of the domestic market. In Germany, in 1996 the Bayerische Vereinsbank incorporated the Bayerische Hypotheken, its major competitor in the sector of retail banking and formed Hypo Vereinsbank. This movement was the first in a sequence of resembling mergers, in the over-saturated market of Germany. In the Swiss market, in August 1997 Credit Suisse merged with Wintethuk and in December of the same year, the Union Bank of Switzerland (UBS) merged with the Swiss Bank Corporation, which led to the emergence of the second largest bank after the HSBC in international level.

Similar policies were adopted by several members of EU and as a result the total number of financial institutions increased. As a consequence the number of banks in EU members was reduced by 20%, during the period 1990-96, which led to an increased degree of centralization.

The degree of centralization can be measured by various methods. One of these methods is the centralization 5 indicator, which calculates the total market share of the top five institutions; the total assets of the top five institutions as a percentage of the total assets of all credit institutions. A more reliable method is the Hertindahl indicator which is defined as the sum of the squares of the market shares of each individual firm. As such, it can range from 0 to 1 moving from a very large amount of very small firms to a single monopolistic producer. Decreases in the Herfindahl index generally indicate a loss of pricing power and an increase in competition, whereas increases imply the opposite. Consequently it presents the structure of the field as a whole, taking into consideration even the small and intermediate institutions. The centralization 5 indicator

presents the market share only for the top five institutions and it does not take into account the structure in the rest of the market.

Consequently, the rearrangement of the European financial system at national level involves a rapid reduction of the number of independent financial institutions and the mustering of market control in a minor number of institutions. The degree of centralization in EU as a total is really insignificant. Differentiation seems to dominate the behaviour of credit institutions due to the denormalization that eliminated the limitation among the different types of financial institutions.

## **2 Abolition of Regulating Barriers**

After the abolition of the regulating barriers, credit institutions including banks, insurance companies etc., changed their traditional roles and via mergers, joint ventures or alliances have progressively undertaken a wider role of financial services supplier. Such activities include insurances, reciprocal capitals, housing loans, financial hires, pawning of requirements etc. Banks, based on their network and their intimate relation with their customers, tend to transform into supermarkets, being able to offer a wide range of financial services. These initiatives were not taken only by banks. Many insurance companies acquired or merged with banks, in order to use their network as an effective mean, for the reduction of cost and distribution of products. These activities aim to increase effectiveness and safeguard economies of range.

Economies of scope distinguish themselves by the use of inputs in the production of multiple services. A new distribution channel approach of a different credit institution is the most characteristic example. Unified customers' accounts, for instance, help avoid the double labour cost which is related to credit status evaluation of customers for each financial transaction. Additionally, the supply of differentiated products leads institutions and customers to long-term relations, which imply progressive customer's knowledge accumulation. Institutions based on differentiated services are less exposed to the danger of a sudden shift in clients' preferences or to economic crises. From the customers' point of view, economies of scale are delivered by gathering all transactions into one institution, a fact that decreases transactions cost, time duration, communication costs etc.

Another reason for this differentiation tendency is related to the penetration of the savings market by non banking institutions, as well as to recent shifts in savings behaviour towards long-lasting capitals, contained in collective investment tools, such as retirement funds, life insurances and reciprocal capitals (Bisignano, 1998). Institutional and technological developments have limited the entry barriers to the banking sector and as a result credit institutions face pressures in their traditional activities by a large number of real or even potential competitors. The development of institutional investors facilitated their access to public savings and strengthened the role of capital markets in capital pumping. Indeed, many enterprises turn themselves to stock market, trying to pump low cost capital. Simultaneously, government supply as well as non banking financial institutions permanently extend the scale of financial products with various characteristics and outputs; increasing public's saving choices and leading to an important increase of placements within the banking system.

Reciprocal capitals as well as insurance products, offer alternative forms of placements. Despite the different rationale behind banking and insurance activities; the former protects against danger and has short-term horizon and stable obligations, while the latter covers the danger, has long-term horizon and non-stable obligations; both refer to public savings. Life insurance has recently been developed in Europe because of positive tax regulations and anxiety towards the future of the retirement system. Another important reason which enabled this development was the new form of life insurance products. These products include the trivial element of protection against dangers, while emphasis is given to profitability and investment opportunities. Life insurance has progressively moved from protection to investment. As a result these new insurance products, in combination with tax regulations and positive outputs, gained public's savings preferences to the expense of banking products.

Depositors are more willing to turn into investors ensuring higher outcomes for their placements and accept higher danger derived by information asymmetry (Pais – Llewellyn, 1998). This tendency was enforced by the creation of new financial products, for example derivatives, which aim at the minimization of undertaken danger by investors. Banking institutions trying to maintain their market share compete with non banking institutions, out of their traditional field. In addition, demographic developments in Europe mainly low birth rates,

limit the number of future customers rendering their devotion to a financial institution particularly fundamental.

The balance-sheets of banks lively illustrate that the importance of interest fees as a source of income for banks has permanently decreased. On the other hand, income derived by attendances in different companies rendering financial services, as well as charges for mediatory works is increased. This tendency is known in United Kingdom as Universal banking multiple transactions, in Germany as Allfinanz and in France as Bancassurance.

However, initiatives were not taken only by banks. Insurofinance, the reverse phenomenon, the entry in the wider area of financial services by insurance companies has taken important dimensions. Various insurance companies entered into partnerships with banks through mergers and acquisitions, in order to use the banking institutions' network as a cost effective way to offer insurance products. Indicatively, it is mentioned that during the decade of 1990 Aachener & Muenchener acquired the control of the fourteenth of the top banks in Germany, the Bank für Gemeinwirtschaft (BfG) with 250 branches, in order to offer a great variety of banking and insurance products to its insurance customers.

Universal banking has its restrictions unless it is developed through joint ventures. It contributes to the need to obtain experience and specialisation in many different subjects, while the co-ordination and the management of new financial super-markets can increase costs. Additionally, consequential conflicts of interests are produced (Fitchew, 1990). Besides, specialisation that often is considered as the suitable way for exploitation of specific specialities, exploitation of managerial simplicity is also considered (Ryan, 1990). Consequently, integrated European market appears to lead to the coexistence of specialised and global financial structures. Specialisation appears more often in sectors where specific specialties are required, like portfolio management of the market research and the investments advisory.

The variety and complexity of certain financial products constitute an additional restriction of Allfinaz. For instance, a specific financial advisor is likely not to sell both banking and complicated insurance products at the same time. Since financial institutions provide contemporary and stilted financial services, a very well counterbalanced and differentiated operational structure is better served by the establishment or acquisition

of minor and specialised enterprises. The last ones might enjoy an important degree of administrative autonomy, continuous work under the control of the shell company. This type of strategy provides a well counterbalanced market cover and as a result they are able to respond to the challenges provoked by the entry of foreign institutions. Additionally, it reduces the risk of costly double works and it results in economies of scale and scope without the utilities of specialisation being sacrificed. The same type of strategy appears to be justified by the general approach of cost reduction, where companies apply division of operations, with the intention to control effectively their functional cost.

### **3 The Ideal Organisational Model**

The suitable organisational model is focused on the development of a financial group with a number of subsidiary companies that offer all the financial services with effectiveness and flexibility, working almost autonomously under the control of the shell company, which is usually a bank, while its network constitutes the basic way for the total promotion of the group. A multifunctional institution with independent entities functionally is proved to be superior in structure and effectiveness to a completely unified financial organization. This functional independence reduces the probability of interests' conflict and facilitates the supervision of financial institutions by supervisory authorities.

Universal banking is already a tendency in Europe with increasing rates which are expected to continue. The main characteristic of the European market is the continuous integration of the financial sector via mergers and acquisitions, attendances or joint ventures, between banks, insurances and other financial institutions (ECB, 1999).

The new European market appears to encourage sizeable financial groups with purely differentiated activities. These activities are undertaken by specialised, semi-independent departments or subsidiary companies. This strategy increases the degree of monopoly with a less visible way. The Community legislation bans monopolistic practices in the rendering of services. However, such practices are difficult to be determined. Consequently, this type of strategy is not directly opposite to the Community directives, even if it can lead to monopolistic situations in regional level, or even if the European financial market is not dominated by a single financial organisation.

## **4 The Role of the Public Sector**

The public sector supports and affects the developments that take place in the financial system. The governments of all EU countries adopted significant changes in their legislation, aiming at the systematic reduction of the governmental interventionism, in order to facilitate the re-composition of the banking system. The reduction of the interventionism is formed as:

1. Abolition of the special treatment towards certain categories of credit institutions where the government participated (landed developmental banks).
2. Cession of the liabilities of governmental financial institutions to other governmental companies
3. Assignment of credit institutions' management to experienced managers according to financial performance criteria.
4. Distribution of stocks of public companies to individuals or other legal entities.

The financial sector of all EU countries is in a transitional level and the traditional banking institutions have suffered competitive pressures by a new form of banking institutions, as well as by non banking financial companies which had important consequences on the structure of the banking sector.

The negative effect on profitability of banks, which is due to the enforcement of competition and to the phenomenon of mediation at the end of 1990, was counterbalanced by favourable economic conditions created by the reduction of interest-rates, which increased their capital profits, and their investment banking income (ECB, 2000a). However, long-lasting pressures on profitability are expected to continue. The introduction of a common currency strengthened and accelerated the prevailing tendencies. More specific, despite the fact that the EMU is expected to lead to a state of macroeconomic stability, to low inflation rates and interest-rates, in addition to higher growth that will increase banking loans and decrease credit danger, the phenomenon of mediation is expected to continue with more intense rates. The need of the institutional investors and the intensifying efforts of enterprises to improve their share-capital will increase capital market's attractiveness for pumping capital against the banking sector. The development of an integrated bonds market with extensive range and depth and increasing



liquidity is expected to lead international institutional investors to an increase of placements in this market, thus putting higher pressures on traditional banking functions.

The inversion of competition conditions encourages the relatively immense size but also the range of the activities so that the exploitation of economies of scale and range to be achieved, and also the synergies that arise from the cross-selling and the multidimensional client service. Given the above facts, reformation of the European banking system via mergers, acquisitions and alliances, is expected to be continued, with an increasing tendency towards aggressive acquisitions. This threat affects many financial institutions, which often announce programs of repurchasing stocks. The purchase of an important parcel of stocks is considered not only an effort to protect themselves against possible acquisitions, but also a tool for a future sale to a desirable buyer.

## **5 Mergers and Acquisitions**

The profits that may arise from mergers and acquisitions can be tremendous. Proportional, however, is the risk that may result to the reduction of shareholders' value. The meaning of the shareholders' value presents continuously increasing importance, in order to distribute wealth and capital to shareholders.

The main problem two banks encounter during their merger is the inability to supervise the course of work throughout the integration process. Companies, which have been incorporated with others, confront a reduction of output before the expected profits become visible. This problem may prove more important than it was expected initially and has truly crucial repercussions in the process of a merger and by extension, to the new organization.

A successful integration requires accurate strategic planning, after real key value drivers have been investigated in order to ensure high efficiency. This planning presupposes an explicit perception of the desirable form of the institution and the nature of services provide. Specifically, in retail banking this precise questioning, regarding the form of the bank is very crucial. This form, as well as the relative action plan for the transition of a conventional bank to the new form, constitutes a strategic choice of the bank. However, the lucrative bank is supposed to provide its customers with complete services without time, geographic or

other restrictions and in addition, these services should be offered with distinguishable trade-mark, in order to enjoy the confidence of the public and to ensure the differentiation of the provided services against its competitors.

Greece could not be unaffected by these developments. A significant number of mergers and acquisitions took place recently. The degree of centralization has been decreased during the second half of 1990. The rate of banks' centralization in Greece was always high. The position of the top state banks in the market is not solidified since distributions, marginal in extent but important in special weight, are observed. As far as competition is concerned, the Greek private banks have the opportunity to exploit their flexibility and to extract market shares from the top state banks. Factors that could favour private banks should be mainly sought in the quality and the timing of customers' services.

It is expected that the Greek banking system will become more centralized, since the re-composition of the European financial sector continues. Moreover, the size of the Greek credit institutions, despite the recent mergers, remains insignificant compared to European and international banking institutions. It is worth mentioning that only Greek banks are included in the top 100 European banks list. The importance of the centralization degree is located in the existence or not of a dominating position in the banking market, while the efficiency of the banking system is also measured. In the old days, the high rate of centralization did not influence the pricing of provided services since this was determined administratively. Today this indicator represents the competition that consumers take advantages.

Operational expenses of Greek banks' remain, as a percentage of occupied capital, higher than the corresponding of the European banks. Major acquisitions ensure economies of scale and an opportunity to enter other markets. Additionally, it compensates the negative results of increased competition within an environment of low interest-rates, and according to international experience, it led to the restriction of the difference between deposits interest-rates and issuing interest-rates and limited income from traditional banking. Moreover, strategic alliances and collaborations with financial institutions abroad aim at the realization of synergies, the expansion of the distribution network and the import of expertise.

The rendering of wholesale services is characterized by particularly increased competition, given the fact that the comparative advantages of domestic credit institutions are eliminated and the presence in international financial centres, without the need for a European network, is required. Corresponding to this certain Greek credit institutions extended their activities in international financial centres, as London and New York, while they developed at the same time off-shore units. The rendering of financial services in large companies will increase, due to the fact that they will be mainly focused on the effort of foreign banks in order to attract customers. These companies are more likely to enter international markets.

Under conditions of increasing competition each bank should determine a suitable strategy with respect to its size, customer policy, supply of products and collaborations, in order to achieve the desired market position and to ensure a successful long-run presence. In the process of upgrading competitiveness, realignments in the structure of the banking system are considered necessary.

## **6 The Cross-Border Extension**

The legislation of the European Union as well as the establishment of the common currency have created new markets and provided new opportunities for cross-border activities. Certain financial institutions reacted to new challenges with cross-border acquisitions and mergers and not with establishment of branches in other countries. The cross-border mergers and acquisitions often offer better conditions for a quick and successful infiltration of new markets. Barclays Bank, for instance, acquired Merck Fink in 1990 (one of the biggest private banks) and European de Bank, in order to acquire an important presence in France, owning roughly 80 subsidiary companies and 100.000 customers. Additionally, Deutsche Bank announced in 1997 that its main priority was to develop in France.

However, a large number of banks remain cautious as far as the rate and the range of reformation in Europe is concerned, in the sector of retail banking (ECB, 2000b). The overwhelming majority of mergers and acquisitions in EU concerns domestic credit institutions. Cross-border mergers and acquisitions are not an ideal medium of growth and extension in European level. Cross-border alliances constitute an alternative strategy. For example there are agreements for distribution of

services which involve a refined foreign supplier of products and a domestic network of distribution. Additionally, they contain an exchange of information and technical expertise often accompanied by reciprocal exchange of shares. A big number of institutions have adopted this strategy in order to develop in European level.

Most cross-border transactions do not involve an important change of ownership or control (Salomon Brothers, 1997). Obviously this strategy does not provide financial institutions with extensive networks of subsidiary companies. Cross-border mergers and acquisitions do not appear to have obtained strategic importance. A number of factors, such as administrative differences, communication difficulties, lack of comprehension of local market, legislative obstacles etc, create barriers in growth via mergers in European level apart from the fact that this policy was proved suitable in national level.

Mergers and acquisitions can reduce inefficiencies, avoid double work, promote rational organisational patterns and lead to economies of scale. This is the case of horizontal mergers between institutions. On the other hand, mergers and acquisitions between institutions operating in different and distant markets, elongate communication and obstruct administrative decisions. As a result, the process of incorporated institutions concerning the achievement of right determined goals with regard to the sectors of the market in which they will be activated and the products will be offered, it would be extended and controversial. Indeed, the management of a sizeable and differentiated institution in European level can be proved such a complicated exercise, that economies of scale will emerge.

On the other hand, someone can claim that a specialised institution can exploit its comparative advantage and its administrative simplicity in order to aim at a European scale. However, the lack of brand recognition can impede the fast and effective penetration of new markets. These arguments are presented extensively in financial – economic bibliography disputing the existence of important economies of scale in the sector of international financial services (Berger – Demsetz – Strahan, 1999; Peristiani, 1997, Gilbert, 1984, Morgan, 1988). The bibliography implies that the output of scale is run out in a relatively low level. Development in foreign markets can provide economies of scale, but usually these are compensated by additional costs in other operations, as for example in management and communication.

Theoretically, the tendency towards the development of EU legislation was expected to eliminate existing regional differences. Nevertheless a significant number of legislative and non legislative barriers (as tax imposition and the degree of monopoly) will still exist. Such barriers will continue to differentiate the European financial system and decrease economies of scale and scope, throughout development.

By all means, someone could claim that mergers and acquisitions would be a corporate answer to existing market barriers. However, rationalism, the degree of conjunction and the consolidation of positions in national markets make mergers and acquisitions more difficult. Mergers and acquisitions of noticeable financial organisations formed by national conjunctions, require enormous economic resources. Restrictions of capital constitute an important barrier in cross-border mergers and acquisitions.

## **7 The European Committee and the Cross-Border Extension**

According to the European Committee cross-border mergers and acquisitions will constantly become more attractive. However, it seems to underestimate the fact that confidence and fame (which also constitutes an important barrier in cross-border development) are of importance for the financial sector where the rendering of services is based, in a large extent, on consumers' confidence. Banking activities and specifically deposits and loans are based on information asymmetry between banks and their clients. This information constitutes an asset for banks and not an easy and immediate product of transaction (Santomero, 1999). The good knowledge of the conditions in local level, allows domestic banks to maintain their comparative advantage and allocate an extensive network of subsidiary companies. In market systems, where brand names are established, advantages derived from cross-border mergers and acquisitions are rather limited. It is worth mentioning that certain banks choose to enter foreign markets by looking for specific and usually small parts of these markets (niche players). The example of Deutsche Bank is characteristic; established in London, after the merger with Morgan Greenfield with sole investment banking activities.

As a result of the existence of no legislative barriers, financial institutions cannot offer effective services in foreign markets. However, if

these services are efficiently produced in foreign countries, then they can be imported by local institutions. Consequently, they can play a mediatory role between foreign institutions and domestic customers. Cross-border mergers and acquisitions are not suitable for institutions that wish to develop in the European market. An institution can develop in foreign countries through corporate relations and alliances. Alliances appear to be more effective if we consider the cost and risk, strategy for cross-border extension, but on the other hand provide limited administrative control. However, in the case of retail services, there is no need of owning a local institution. The offered customers' services depend on personal relations and on mutual confidence. Effective operations in local level require local comprehension. National institutions continue to be staffed by domestic personnel, even if they are merged or acquired by a foreign institution.

Indeed, given the fact that there is lack of sufficient financial resources the path to European integration and the need for cross-border development, requires the development of an European network which force many financial groups to shape alliances and agreements of collaboration with other foreign financial institutions. Many banks, for example, have already established large European networks of correspondents aiming customers, in other national markets. The establishment of correspondents can be the substitute of international representation for an institution and tend to be simple technical agreements of collaboration, often taking the form of alliances that aim at the distribution of products. Mutual exchange of information in a variety of ways, such as foreign exchange, products and financial settlements, is also covered.

In recent years the nature of traditional correspondents' relations has been transformed. Emphasis is given on a more effective and reliable system of payments in favour of customers and this seems to push financial institutions to the promotion of this rational integration process, creating international strategic alliances with local correspondents. These alliances usually take the form of small reciprocal placements in the share capital of banks. Such reciprocal share capital agreements are also drawn in order to deter efforts of acquisition from other competitors. While the objective of cross-border mergers is a choice which is adopted by a small number of financial institutions, the strategic alliances appear to provide the most suitable settlement for the majority of cases.

The alliances of Credit Lyonnais (France), San Paolo di Torino (Italy), Dresdner Bank (Germany) and Banco Santanders (Spain) represent the general tendency. This strategy does not provide financial institutions with extensive networks of subsidiary companies, neither with important market share abroad.

The developments in the European and international area are expected to contribute to a more intense promotion of strategic alliances and collaborations between Greek credit institutions as well as between Greek and European banks, aiming to enter new markets, the expand distribution networks and import know-how. The agreement of collaboration between Emporiki Bank and a French bank, Credit Agricole, is indicative of this tendency.

## **8 Deregulation**

The unification of the European financial market due to the emergence of EMU has changed the financial regulation in the participating countries. After the abolition of the regulating barriers, credit institutions such as banks, mutual funds, insurance companies etc., have shifted from their traditional role and via mergers, acquisitions, consolidations, joint ventures or alliances, have progressively undertaken a bigger role in their industry. Their activities now include insurance services, mutual funds, mortgage loans, financial leasing, factoring, forfaiting etc. Both banks and insurance companies have enlarged and developed their activities, based on their network and on their intimate relation with their customers. They tend to transform themselves into supermarkets, having the ability to offer a large variety of financial services (Berger – Hannan, 1997). These activities aim at the increase of the effectiveness and the safeguarding of economies of range, while data integration, which is used for providing multiple services, leads to significant economies of scale. The economies of scale distinguish themselves by the use of inputs in the production of multiple services. The use of an economic channel of distribution of a different credit institution is the most characteristic example (Llewellyn, 1999; Bisignano, 1998).

Institutional and technological developments have limited the entry barriers in the banking sector and as a result credit institutions face pressures in their traditional activities by a large number of real or even potential competitors. The development of institutional investors

facilitated their access to the public savings and strengthened the role of capital markets. Indeed, many enterprises have turned themselves to the stock market trying to acquire low cost capital. Simultaneously, the supply of a permanently extending scale of financial products, not only from the financial institutions but also from the Public sector, in the form of public bonds, as well as from non banking financial institutions, with various characteristics and outputs, has extended the public's saving choices and has led to an important increase of its placements within the banking system.

## **9 Financial Innovations**

Technology has altered the basic economic principles of banking, has facilitated the manipulation of large scale information, has improved control and risk management and has allowed faster execution of transactions and development of attractive financial offers. Furthermore it has allowed a more efficient supply of the existing products and services; it has increased the economies of scale in banking processes, the administration access in information and has altered the supply economics. Since banking is unbreakably connected with the use of information technology, anything that influences the supply, the cost and the management of information also influences decisively the operation of credit institutions. The various technological achievements have developed new access opportunities for the evaluation and exploitation of economic information, derived from the markets. As a consequence, the competitive advantage that traditional banks enjoy, as far as collection, information processing and credit risk evaluation is concerned, has been progressively corroded (Accenture and Siebel Systems, 2000).

Electronic banking and customer services, using modern electronic channels, such as mobile telephone networks, television and wireless appliances, constitute a new way of transaction with the bank. This is a new reality, which is called remote banking; it has broadened the horizons and has influenced all banking processes (ECB, 1999). ATM transactions, telephone banking and PC banking using internet connection software are parts of remote banking. The growth of the alternative telephone-service's networks has decreased perceptibly the cost of execution of transactions from 1% to 25% using internet banking, and from 40% to 71% using telephone banking. Today, remote banking constitutes a small part of realised transactions. The importance of alternative networks will



increase, as the new generation, which is familiar with the use of modern technology, will utilize even more of all the new available distribution channels. Nowadays, financial institutions compete with each other in a more transparent market where the modern banking customer, who has easier access to information, has the ability to compare different products according to price and quality.

In many sectors of the banking industry the result of new technology is two fold. Firstly it creates higher economies of scale and secondly it increases the effort that is required, in order to achieve the ideal size. A credit institution, which has the perfect size but an out of date technology, can function at higher cost compared to larger competitors, which use new technology. However, the installation of new technology involves higher cost, which can be restrictive for many credit institutions. In this case small institutions can achieve essential economies of scale by entrusting specific parts of products and services to independent specialised companies, by outsourcing their needs.

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### **ABSTRACT**

The international tendency towards the deregulation of restrictions and administrative settlements has suppressed the barriers between national financial markets. The adoption of a common currency and the rapid spread of new technologies lead to intense competition, imposing the acceleration of reformations in the European financial sector. Financial institutions have consequently adjusted their strategies, in order to confront the challenges and exploit the opportunities of new developments.

In this work, a review of strategies that have been applied by financial institutions in the most important European markets is presented, as well as the repercussions of those strategies on the structure of the European financial sector. The controversial question is which form of affiliation will allow them to encounter successfully the expected intensity of international financial competition.

**Key words:** European financial system; Deregulation; Structural change; Mergers and acquisitions; Regulating barriers; Cross-border extension.

**JEL classification:** E5, G2, G34.