

## An Anglo-German Foundation Report

# The British Banking System: A good role model for Germany?

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## Executive Summary

- The British financial system is widely regarded to be more efficient than the German system. There is talk of the need to reform the German financial system. But is reform of the German banking system necessary, are there traits worth conserving and does the UK banking system provide a good role model?
- We tackle these questions by comparison of the supply of financial services to micro and small enterprises (MSEs) as well as to low-income households in the two countries.
- We find that the German public savings and mutual co-operative banks provide good payment services and access to finance to nearly all citizens, and serve the MSE sector well through their extensive regional and local branch networks. In contrast, there are serious access to payments services and finance issues in Britain, the Competition Commission has found a 'complex monopoly' in the provision of small business bank account services and there have been widespread branch closures.
- Furthermore, there seem to be fewer problems with over-indebted households in Germany than in Britain. The more widespread use of credit cards in Britain could be responsible for this. Aggressive marketing of these cards as well as excessively high penalty charges to credit card users who pay late, or are unable to clear their balances, contribute to the problem of over-indebtedness. The punitive charging in Britain is indicative of much more widespread cross-subsidisation in the provision of current accounts – high-balance, low-volume users generally cross-subsidise low-balance high-volume users due to low deposit interest payments and low charges (for those who stay within authorised credit limits, with punitive charges for those who do not, or cannot).
- The relatively high profitability of British banks in recent years may therefore owe much to exploitation of their 'complex monopoly' power. In contrast, the lower profitability of German banks is associated with a broader supply of financial services to small enterprises and low-income households. However, the *Sparkassen* (municipal savings banks) and co-operative banks, which are the most active banks in these market segments, have had an above average profitability in Germany.

These findings should be borne in mind by advocates of increased concentration trying to shift the German system towards the British model.

- Public sector and co-operative savings banks are no longer a significant force in Britain, and indeed the government has been encouraging the development of Community Development Financial Institutions (CDFIs) and credit unions to fill the gap. Advocates of privatisation of the German public savings bank should also bear this in mind.
- If increased concentration in German banking can be shown to be necessary in order to achieve efficiency gains, then mergers involving the recently partially privatised Postbank and a (partial?) privatisation of the regional central banks of the savings bank sector (the *Landesbanken*) should be considered.
- There seems to be an inadequate supply of private equity to medium-sized enterprises and companies (the *Mittelstand*) in Germany, relative to Britain, and this is a gap that the large German ('private') banks, rather than the *Sparkassen* or the co-operative banks, might naturally try to fill (in competition with other European banks, private equity and venture funds).

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**Notes to the editor:**

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