

The German Banking System – Types of Banks and Experience in the Crisis

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1. The German banking system

The banking system in Germany is a universal banking system. This means that financial institutions in Germany are permitted to conduct all types of banking activities described in Section 1 of the German Banking Act. In addition to universal banks, there are also a number of special banks which mainly for historical reasons limit their activities to selected, single types of business. Among these are building societies/home loan savings banks and direct banks.¹

1.1 Three pillar structure

Universal banks in Germany can be divided into three main types of institutions: commercial banks, public-sector banks belonging to the savings bank sector, and cooperative banks. This division is commonly known in Germany as the three pillar structure, a term which expresses the strict separation of these groups.

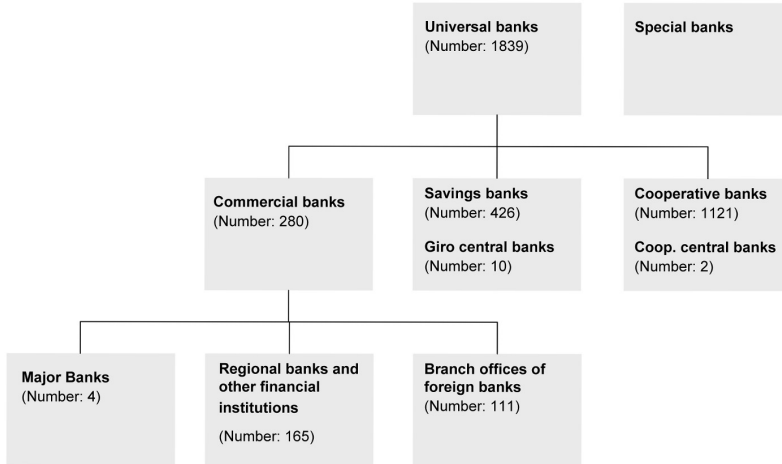
Commercial banks are part of the private sector, i.e. government entities do not generally hold stakes in them, and can be further sub-divided into large, nationwide (major) banks, regional banks and other financial institutions, including the branch offices of foreign banks. The savings bank sector includes savings banks and Landesbanks/giro (transfer and clearing) central banks. The institutions in this pillar are owned by local or regional government entities such as municipalities, states or special purpose associations. The cooperative bank sector comprises cooperative banks (e.g. Volksbanks and Raiffeisenbanks) and their two central banks, DZ-Bank and WGZ-Bank.² An overview of the structure of the German banking system is provided in Figure 1.

Other than their legal form and business goals, the principal difference in the types of universal banks is the number of legally independent institutions they have and the number of branch office locations. For example, commercial banks, which have no geographical limits on the areas they serve, have far fewer legally independent institutions than savings banks and cooperative banks which are limited to serving certain geographical areas. Commercial banks also have fewer branch offices and these are for the most part found in urban areas. Savings banks and cooperative banks, on the other hand, also have a strong presence in small towns and rural areas.

¹ See Hartmann-Wendels, T., Pfingsten, A., Weber, M. (2010), pp. 29 ff.

² See ebenda.

Figure 1: Structure of the German banking system and number of universal banks



Source: Bundesbank (2012), pg 24 ff., as at: July 30, 2012

In terms of total assets, the four major German commercial banks (Deutsche Bank AG, Commerzbank AG, UniCredit Bank AG and Deutsche Postbank AG) account for nearly 65%.³ This reflects the particular importance of the major banks. For this reason major banks in particular will be used in the following discussion for comparison purposes in addition to the savings banks and cooperative banks.

Not only the number of banks in each group is of interest but also the numbers of branch offices, employees, and customers should be looked at. An overview of this information can be seen in Figure 2.

Figure 2: Key figures for the bank groups

	Major Banks	Savings Banks	Cooperative Banks
Number	4	436	1.123
Branches	8,132	13,496	12,057
Employees	171,309	285,850	163,350
Customers	Approx. 26.8 m	Approx. 41.4 m	Approx. 26.0 m

Source: Deutsche Bundesbank, Bundesverband deutscher Banken, Deutscher Sparkassen- und Giroverband, Bundesverband der Deutschen Volksbanken und Raiffeisenbanken, as at: 2011

³ Hartmann-Wendels, T., Pfingsten, A., Weber, M. (2010), pp. 32 ff.

1.2 Business aims

For the major banks, as with all private-sector commercial banks, making money is the main purpose of business.⁴ In contrast, maximizing profits is not the highest priority for public-sector banks and cooperative banks.

According to Section 1 of the Bavarian Savings Banks Directive (SpkO), the savings banks have the following task: “Savings banks are independent commercial enterprises owned by municipal governments with the task (public mandate) of providing all elements of society and the economy, particularly the Mittelstand, and the public sector, with appropriate and sufficient financial and lending services within the area they serve, including the countryside, in accordance with the requirements of the market and competition, in order to strengthen competition.”⁵

Savings banks are thus committed by their municipal ownership to serving their local region. Profits that are not needed to further strengthen their capital bases are used for the benefit of society. Rather than fixating on financial figures, savings banks concentrate on benefiting the welfare of the people and businesses in the areas they serve. Accordingly, the business policy of the savings banks focuses on sustainable economic growth and social development in their regions. For this reason, the business of the savings banks revolves around transactions centred on the real economy instead of international financial markets.⁶

This commitment to the community does not mean however that savings banks must forgo making a profit.⁷ Making a profit is not the main goal but rather a means of fulfilling their public mandate.⁸

Cooperative banks are cooperative societies (i.e. owned by their members) which carry out all types of typical banking and related services.⁹ By cooperative society is meant a society in which the number of members is not fixed and which serves to promote the business or economic interests of its members through jointly-owned business operations.¹⁰

Because the number of members is not fixed, the assets of the registered society are not dependent on members joining or leaving it. The cooperative society is not obliged to automatically accept all applicants.¹¹ But membership in a cooperative bank does carry with it significant value. This can be seen in the fundamental principals that define a cooperative bank. In accordance with these, a cooperative bank is a self-help organisation that forgoes government or other kinds of support. Its members aim to overcome dis-

4 See Eim (2004), p. 17.

5 See SpkO (2007).

6 See DSGVO (2008).

7 See Jöhnk, T., Zimmermann, G. (2001), pp. 116 ff.

8 See Geiger, H. (1992), S. 35; Grundmann, R. (2001), pp. 75 ff.; Immenga, U., Rudo, J. (1997), pp. 21 ff.

9 See Dullenkopf, I. (2001), p. 5.

10 See GenG (2007).

11 See Dullenkopf, I. (2001), p. 5.

advantages through their own resources by voluntarily joining together, independently gathering funds and conducting jointly-owned business operations.¹²

Cooperative banks have however become less member-centric. This has come about due to the fact that cooperative banks are now permitted to establish business relations with non-members.¹³ Since the repeal of the identity principle for lending transactions, they no longer have to restrict themselves to business with members. From the bank’s viewpoint, this means that members and non-members have been put on equal footing. For this reason, cooperative banks now differ very little from other universal banks.¹⁴

Still, in accordance with the Cooperative Bank Act which applies to all German cooperative banks, they are required to promote the interests of their members. In contrast to commercial banks, maximizing profits is not their highest priority. But making a profit is a prerequisite for staying in business and surviving for the long-term. This is no less true for cooperative banks and they act accordingly.¹⁵

Figure 3 summarises the differences in the aims and ownership of the three different bank groups.

Figure 3: Business aims of banks

	Major Banks	Savings Banks	Cooperative Banks
Owners	Shareholders	Municipalities	Members
Aim	Profit Maximization	Profit Optimization + Promotion of region	Profit Optimization + Promotion of members

12 See Dullenkopf, I. (2001), pp. 6 ff.

13 See Eim, A. (2004), p. 27; Lenfers, G. (1994), pp. 74 ff.

14 See Bolsinger, H. (2001), p. 10.

15 See Theurl, T. (2002), p. 79.

2. The German economy

2.1 A land of small and medium-sized companies

Germany’s economy is characterised by a large number of small and medium-sized enterprises (SMEs) known collectively as the “Mittelstand”. These companies employ fewer than 500 workers each but are responsible for roughly three out of four jobs in Germany.

A great number of Mittelstand companies owe their success to specialising in the production of high-value niche products. Germany exports capital goods to all parts of the world and even smaller companies are world market leaders in many segments. This has enabled Germany to maintain its status as a highly industrialised nation in contrast to many other countries which have seen their industrial bases shrink. The automotive, electro technology, machine engineering and chemical industries make up the largest industrial segments in the country. Altogether the industrial sector accounts for around one-fourth of total economic output. However, the service sector, which includes advertising, finance, and customer services for example, is increasingly gaining in importance.¹⁶

Figure 4 highlights the importance of SME/Mittelstand companies in the economy by means of a comparison to large companies.

Figure 4: Comparison of SMEs and large companies

	Large companies	Medium sized companies	Small sized companies
Size			
- Employees	> 500	< 500	< 10
- Turnover	> € 50 Mio.	< € 50 Mio.	< € 1 Mio.
Number	0.01 Mio.	0.36 Mio.	3.31 Mio.
(Percentage)	(0.3 %)	(9.8 %)	(89.9 %)
Employees	24 %	58 %	18 %
Equity ratio	30.3 %	21.4 %	12.1 %

Small and medium-sized enterprises (SMEs)

Source: DSGV (2012)

16 See IW (2012).

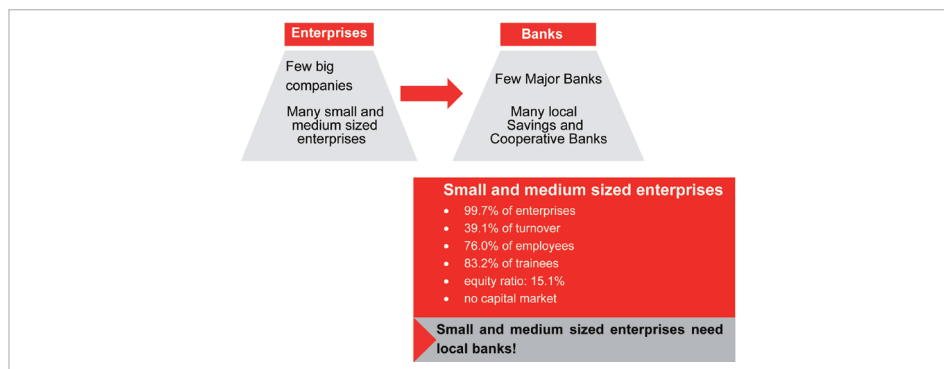
In addition to their enormous economic output, the SMEs are valued just as much for their importance to employment, training, and innovation. To this can be added their less apparent but even more important role as the country's economic stabiliser. Broad-based, diversified, and granular economic structures have proven to be more flexible and resistant to crises than "one-trick pony" economies which are dominated by one sector. This can be especially seen in turbulent times when the Mittelstand really reveals its robustness. Over the past few years both the real economy and the financial sphere have been rocked by the worst peacetime economic crisis in over 80 years. But during the whole time, the German Mittelstand was as steady as a rock, neither causing nor strengthening the crisis. Rather, it played a stabilising role in many areas and developed new strengths in the process.¹⁷

2.2 Banking system and economy fit together

Just as German companies can be divided into large companies and SMEs – as already discussed – the German banking system tends to be made up of a mix of smaller, mostly regional banks and larger institutions.

A glance at the number of companies or banks in the respective sectors shows that there are many small and medium-sized companies on one side while smaller savings banks and cooperative banks account for by far the largest share of financial institutions on the other side. The same balance can be seen in the number of employees in each of the sectors or in other figures. What should be remembered in regard to the German economy and the German banking system is that they go well with each other. Figure 5 illustrates this relationship.

Figure 5: The banking system must fit the economic structure



Source: DSGV (2012)

17 See DSGV (2012), pp. 12 ff.

3. Experience in the crisis

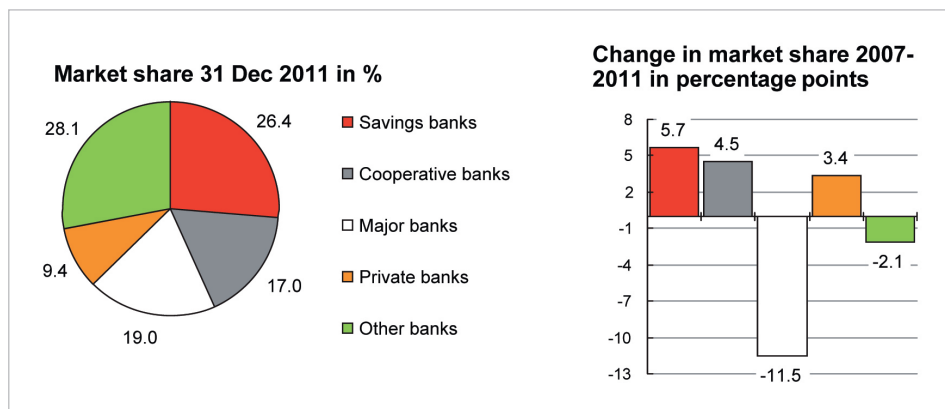
The German banking system with its three pillar structure has a stabilising effect in times of economic crisis. Using different indicators, the following will briefly illustrate this point.

3.1 Customer behaviour

Customer behaviour can be determined using several different indicators. One example is the market share of each banking group of lending to small and medium-sized enterprises and the changes in this over time.

At the end of 2011, the market share of local and regional financial institutions, that is, the savings and cooperative banks, was a good 43%. That of the major banks, on the other hand, was 19%. The change in these figures over the past five years also shows a clear trend. While the market share of savings banks has risen by 5.7 percentage points and that of cooperative banks by 4.5 percentage points, that of major banks has lost 11.5 percentage points since 2007 (Figure 6). This is a clear signal that confidence in banks rooted in their regions and dedicated to traditional banking business rises in times of crisis and underscores the correctness of a banking system that is divided into three sectors.

Figure 6: Market share of lending business with SMEs

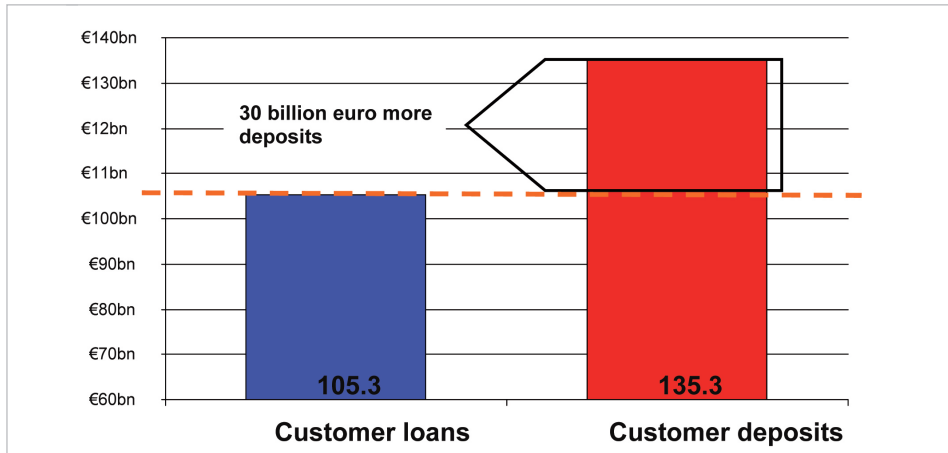


Source: Deutscher Sparkassen- und Giroverband, Sparkassenverband Bayern 2012

A comparison of total deposits to total loans also illustrates customers’ confidence in “smaller” financial institutions. Taking the Bavarian savings banks as an example, it can be seen that deposits exceed loans by approximately EUR30 billion (Figure 7). This shows that people feel their deposits are safe in savings banks. It also refutes the frequently mentioned fears of a “credit crunch”. In fact, just the opposite is true. Bavarian

savings banks have increased lending during the crisis and thus contributed to stimulating the economy.

Figure 7: Deposits vs. lending in Bavaria in 2011



Source: Deutscher Sparkassen- und Giroverband, Sparkassenverband Bayern

3.2 Risk situation

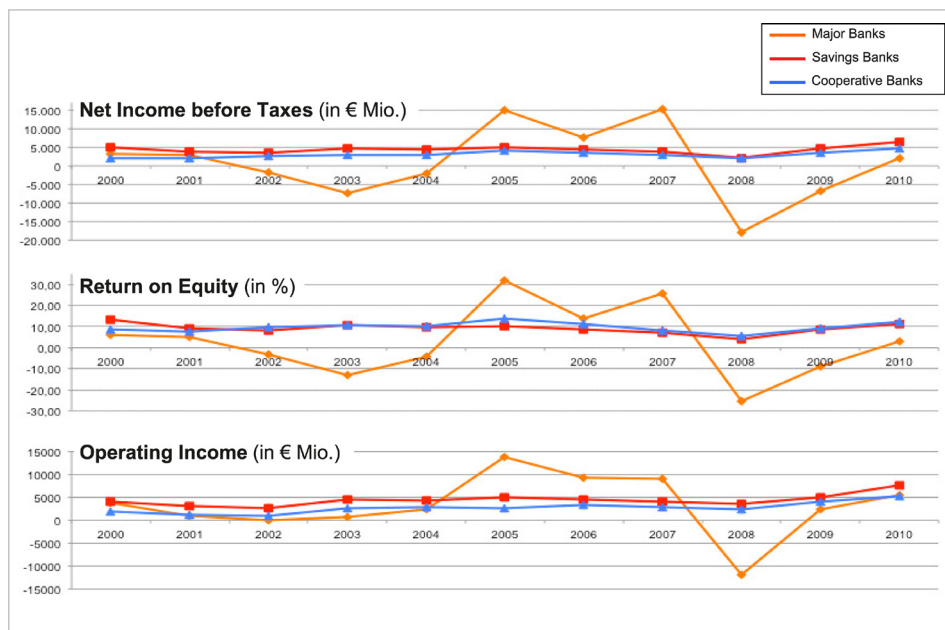
Even though the savings banks have increased lending during the crisis, the associated risks have fallen. This can be seen by a glance at net write downs on loans. Since the beginning of the 2000s, impairments at German savings banks have dropped sharply and are now around 0.

3.3 Profitability

Besides the risk situation, profitability figures during the financial crisis also indicate how the German banking system has proven itself. A look at profitability over the past ten years clearly shows the volatility in the profitability of major German banks. This is revealed by several different profitability metrics. Figure 9 shows net income before taxes, return on equity and operating income. For the major banks, these three figures show sharp spikes and big drops in profitability reflecting the booms and busts of the economy.

In contrast, the profitability of the savings banks and cooperative banks has been relatively steady. These two bank groups are far less susceptible to big swings in profitability. Rather, it is the steadiness of the profitability which stands out. Of course, this also means that there is no upside explosion in profitability in boom times. But if you recall the business aims of these institutions, that is exactly the way it should be.

Figure 8: Profitability over the past ten years



Source: Deutscher Sparkassen- und Giroverband, Sparkassenverband Bayern

4. Conclusion

The German banking system with its three pillar structure is a good fit for the business structure in Germany. Germany, as a land of small and medium-sized enterprises, also has numerous local banks whose size and business strategies are directed at supporting the Mittelstand. The economy benefits greatly from having a banking system and company structure that fit together well or is even made for each other.

This system has also proven itself in times of economic crisis. Savings banks and cooperative banks have proven to be stabilising factors in turbulent times. They increased lending while decreasing risks and posted steady earnings while doing so. Customers have not lost confidence in the savings banks and cooperative banks. The willingness to work together is the most important prerequisite for this.

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