Spanish Banks: Still Some Room for Consolidation and a Lot of Excess Capacity

In this report, Scope looks back at the tectonic shifts in the competitive environment for Spanish banks that have occurred over the past decade. Among the large European banking systems, Spain has seen some of the greatest consolidation, moving from a myriad of banks and savings banks with largely immaterial franchises to a handful of powerful banks with strong national or, at least, regional franchises.

Consolidation took place under duress. Many savings banks had been mismanaged and incurred unsustainable credit losses in their real estate exposures. As a consequence, they eventually had to be rescued or merged into stronger competitors. We believe that the consolidation that followed the crisis has made the system more structurally resilient, for several reasons. In a buoyant market, small banks may be inclined to compete for volumes and market shares, sometimes at the expense of appropriate risk-adjusted, through-the-cycle profitability.

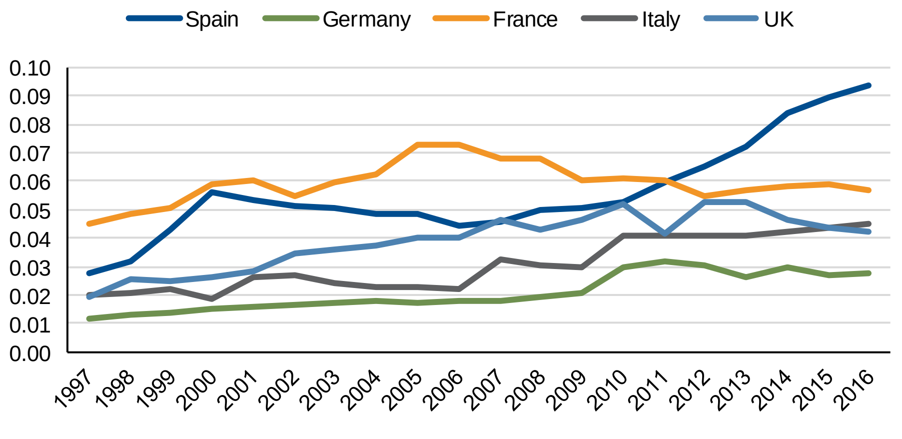
Consolidation often brings more capacity for investment in risk management systems as well as some business diversification by adding new regions or franchises that cater to different customer segments. Not unfrequently, it also brings increased scrutiny from markets and supervisors, which tends to result in governance improvements.

Scope believes that there is still more room for consolidation in the market, as some of the larger players may still be looking to reinforce or complete their franchises. The regional banks have attractive franchises, and are largely profitable, although still burdened by legacy non-performing assets and costly distribution structures.

Although sector consolidation has acted as a catalyst for the reduction of often overlapping branch franchises, a lot remains to be done. We estimate that if the current pace of decline is sustained (-7.3% in 2016), the number of bank branches will have halved by 2025.

With limited branch overlaps likely in future deals, obvious cost synergies from physical distribution may be less material than in the past, but the push for consolidation may be driven by the need for heavy IT investment in order to stay up to speed with rapidly changing customer behaviour.

Figure 1: Herfindahl-Hirschman index, banking systems of major European countries (%)



Source: ECB

Note: Ranging between zero and one, the Herfindahl-Hirschman index (HHI) is a commonly accepted measure of market concentration, calculated by squaring the market share of each firm competing in a market, and summing the results.

Analyst

Marco Troiano, CFA
m.troiano@scoperatings.com

Associate Analyst

Alvaro Dominguez Alcalde
a.dominguez@scoperatings.com

Investor Outreach

Michael Pinkus
+49 30 27891 146
m.pinkus@scoperatings.com

Related Research

Santander's Acquisition of Popular: Regaining the Upper Hand in Spain, 23 June 2017

Scope Ratings AG

Suite 301
2 Angel Square
London EC1V 1NY

Phone +44 20 3457 0444

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100
Service +49 30 27891 300

info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

International banks, national champions and powerful regional banks

Caixa, BBVA and Santander have round, nationwide franchises

Currently, the Spanish system is quite heterogeneous: the large international banks BBVA and Santander, as well as Caixabank, have widespread nationwide franchises, which they have strengthened in the past few years by acquiring troubled competitors.

Caixabank has a vast branch and ATM franchise, with a dominant position in its home region of Catalonia. During the crisis, it was a key consolidator, strengthening its nationwide franchise through the acquisition of Banca Civica (Navarra, Canarias, Andalucia, Castilla Leon) and Banco de Valencia (Valencia).

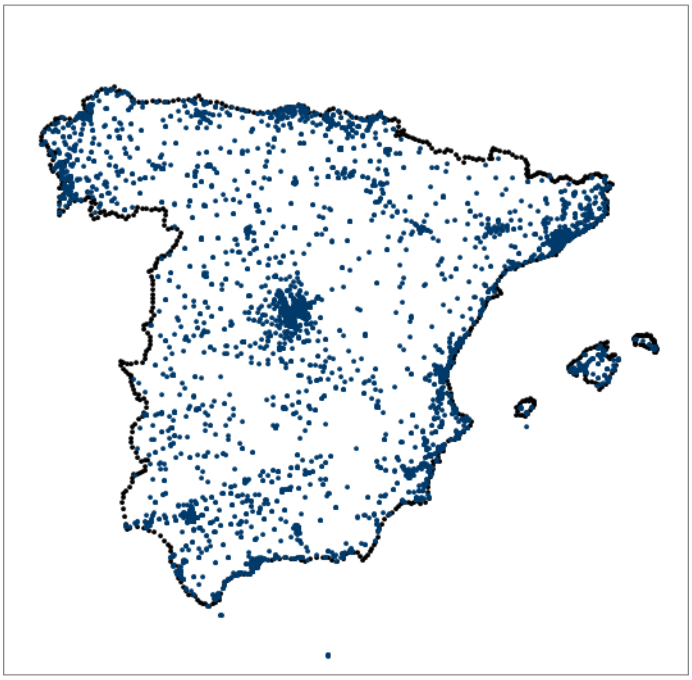
BBVA moved in the opposite direction, strengthening its presence in the attractive region of Catalonia with the purchase of Unnim and Caixa Catalunya during the crisis.

With the acquisition of Popular, Santander has regained its position as market leader in Spain as well as absorbing Banco Pastor's strong network in Galicia.

Figure 2: BBVA's domestic branch franchise

Source: SNL, Scope Ratings

Figure 3: Santander domestic franchise



Source: SNL, Scope Ratings

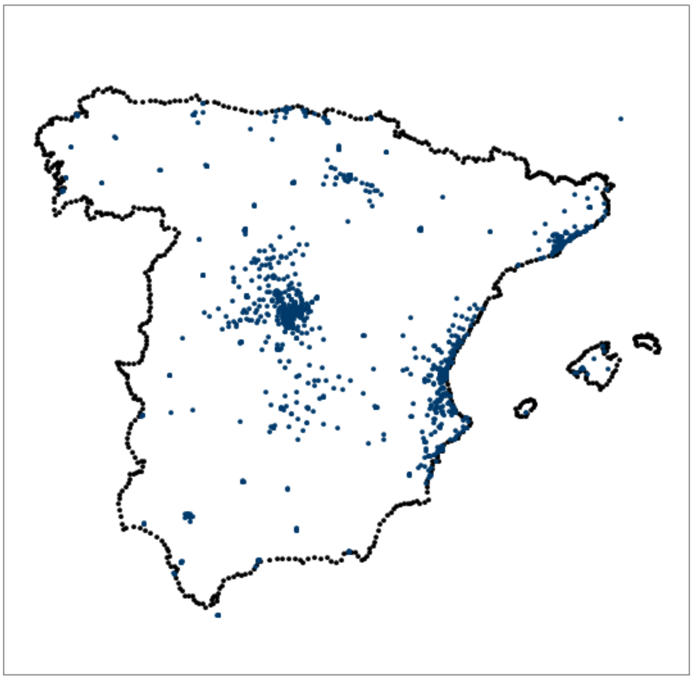
Bankia and Sabadell have spottier networks, but national aspirations

A second group of banks, including Bankia and Banco Sabadell, have emerged as relevant players on a national scale, but their franchises remain patchier, with very strong positions in their historical home regions and little to no presence in the rest of Spain.

For example, Bankia, originated from the merger under duress of Caja Madrid (Madrid Region), Bancaja (Valencia Region) and other smaller savings banks, or cajas, in the regions of Catalonia, La Rioja, Castile and León, and the Canary Islands. Its current franchise still clearly reflects its heritage. The 2017 acquisition of BMN added leadership positions in Murcia, Granada and the Balearic Islands.

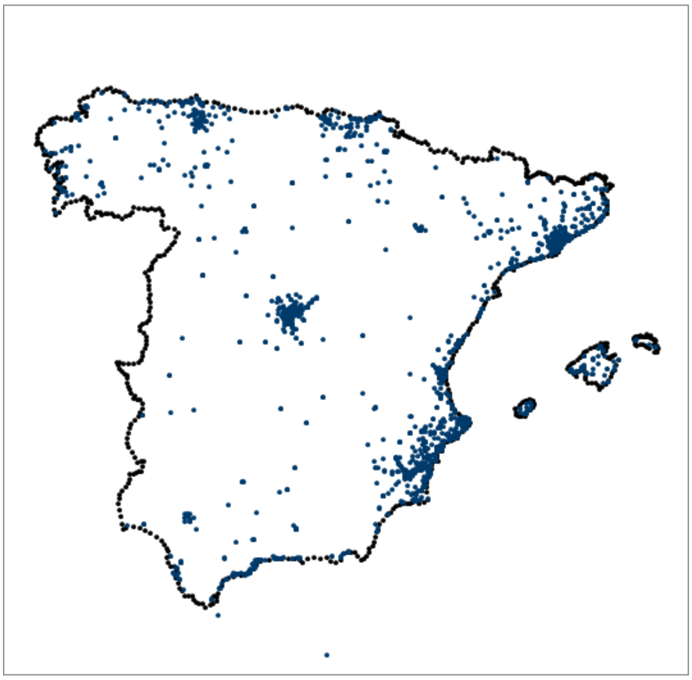
Similarly, Sabadell's franchise reflects its roots in the region of Catalonia as well as its acquisitions of regional banks during the crisis (Guipuzcoano in the Asturias, CAM on the Mediterranean coast, and Banco Gallego in Galicia).

Figure 4: Bankia's domestic franchise



Source: SNL, Scope Ratings

Figure 5: Sabadell's domestic franchise



Source: SNL, Scope Ratings

Bankinter is present in most large cities

Bankinter's franchise is somewhat different, with few branches in the major cities, but more dispersion throughout the country. This distribution model reflects Bankinter's strategy of targeting wealthy individuals and corporates, for which the bank does not require capillary distribution.

Regional banks often dominate larger competitors at the local level, and rarely overlap

The other banks have smaller franchises in terms of overall branches, but it is not unusual to find them dominating the national champions in their home regions. These groups, predominantly located in the north of Spain, are often the result of a strong regional savings bank acting as the key pole of consolidation for other struggling savings banks. Data on market share is not reported homogeneously and is patchy, but is not unusual to find well-established regional banks commanding over 30% of market shares in retail loans and deposits in their home regions.

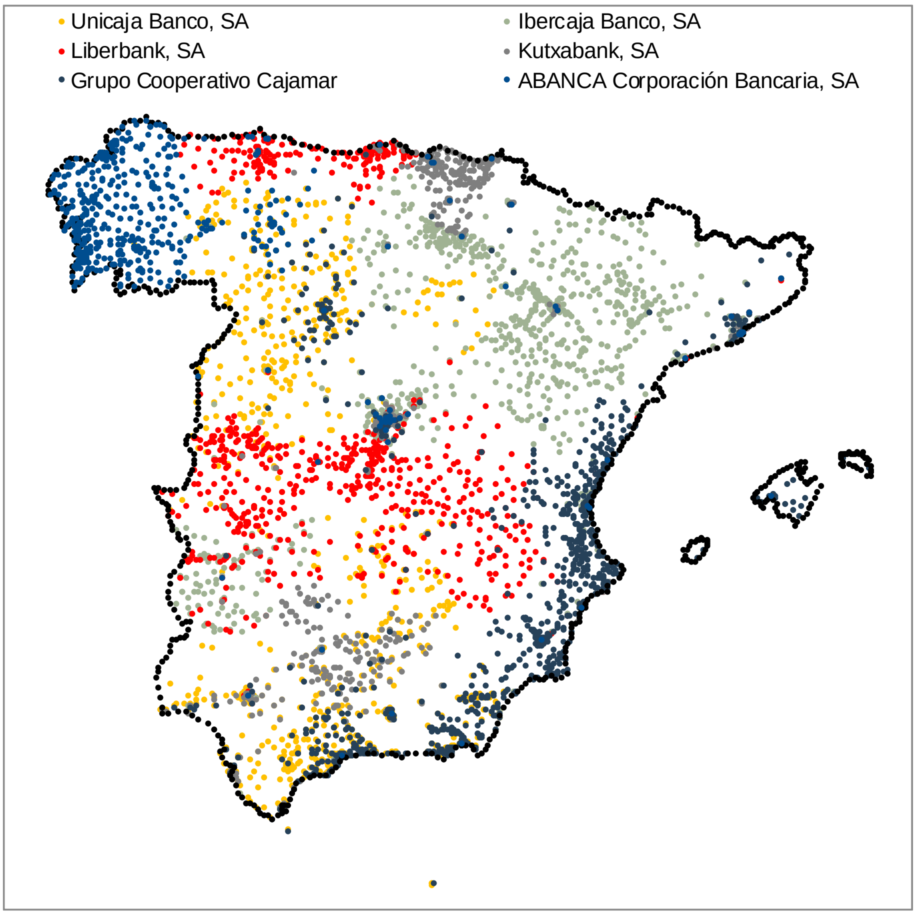
In the wealthy north-eastern regions of Spain, Ibercaja has a 40% market share in its historic home region of Aragon, one of the wealthiest regions in Spain, and double-digit market shares in the surrounding regions of La Rioja, Guadalajara and Burgos. Similarly, Kutxabank dominates the market in the rich Basque Country (in 2016 it reported a 38% mortgage market share).

In the north-west of Spain, Liberbank reports a 34% market share in its core regions, primarily Asturias, while Abanca dominates the region of Galicia (40% of deposits).

Unicaja has 1,279 branches, but these are primarily concentrated in Andalucia and Castile and León, where it commands double-digit market shares in loans and deposits.

Finally, the cooperative group gravitating around Cajamar controls a double-digit market share in the region of Murcia, although it has a considerable presence in several other regions as well. As shown on the following map, there is almost no overlap between the franchises of the regional banks, which means that while Spain has a dozen relevant-sized players, competition at the local level is generally limited to a handful of banks.

Figure 6: Regional cajas, each to their own

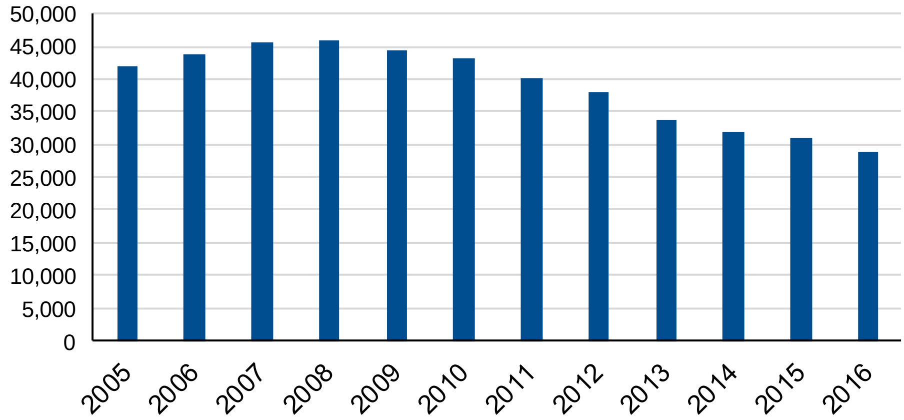


Source: SNL, Scope Ratings

Spain is still one of the EU countries with high bank branch density

Over the past decade, the Spanish banking system has undergone a sharp adjustment with restructurings, mergers and material capacity reduction. The number of bank branches fell from a peak of over 46,000 in 2008 to approx. 29,000 in 2016, a reduction of more than one third.

Figure 7: Spanish bank branches (2005-2016)



Source: ECB, Scope Ratings

Most of this reduction was driven by the former savings bank sector, which underwent a deep process of restructuring in the 2009-2015 period. Since 2009, and often with the support of the Spanish fund for orderly restructuring, dozens of savings banks have disappeared into Institutional Protection Schemes or larger banking groups. (see Appendix 1 for a summary of the M&A activity in the Spanish banking industry over the past decade).

The bursting of the real estate bubble sparked a wave of consolidation

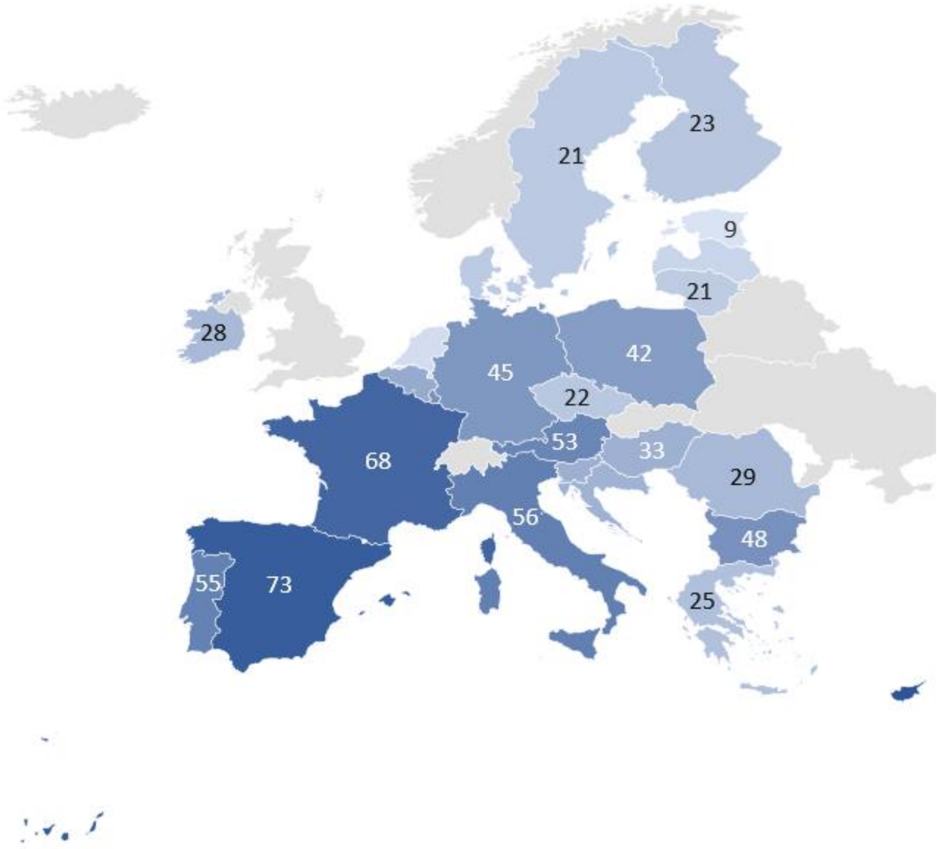
The bursting of the real estate bubble, which laid bare the often inadequate risk and corporate governance at many institutions, sparked a wave of consolidation.

Even with the bank closures of the past decade, Spain remains one of the countries with a high number of bank branches per bankable population. We calculate that there are 73 bank outlets to every 100,000 Spanish adults, compared to an average of 47 for the EU. Moreover, this number has been falling everywhere as the banking relationship increasingly moves away from the physical branch and towards digital channels. (for more details see our recent report "Digital challenge looms larger for European banks", published on the 5th of December)

The number of branches could halve by 2025

Scope believes that further branch reductions are unavoidable. We estimate that if the current pace of decline is sustained (-7.3% in 2016), the number of bank branches will have halved by 2025. While this scenario may appear extreme at present, it would still not take Spanish banks' physical distribution capacity to levels comparable with countries in which the adoption of digital banking channels is more advanced, such as the UK or Scandinavian countries (see Figure 8 overleaf).

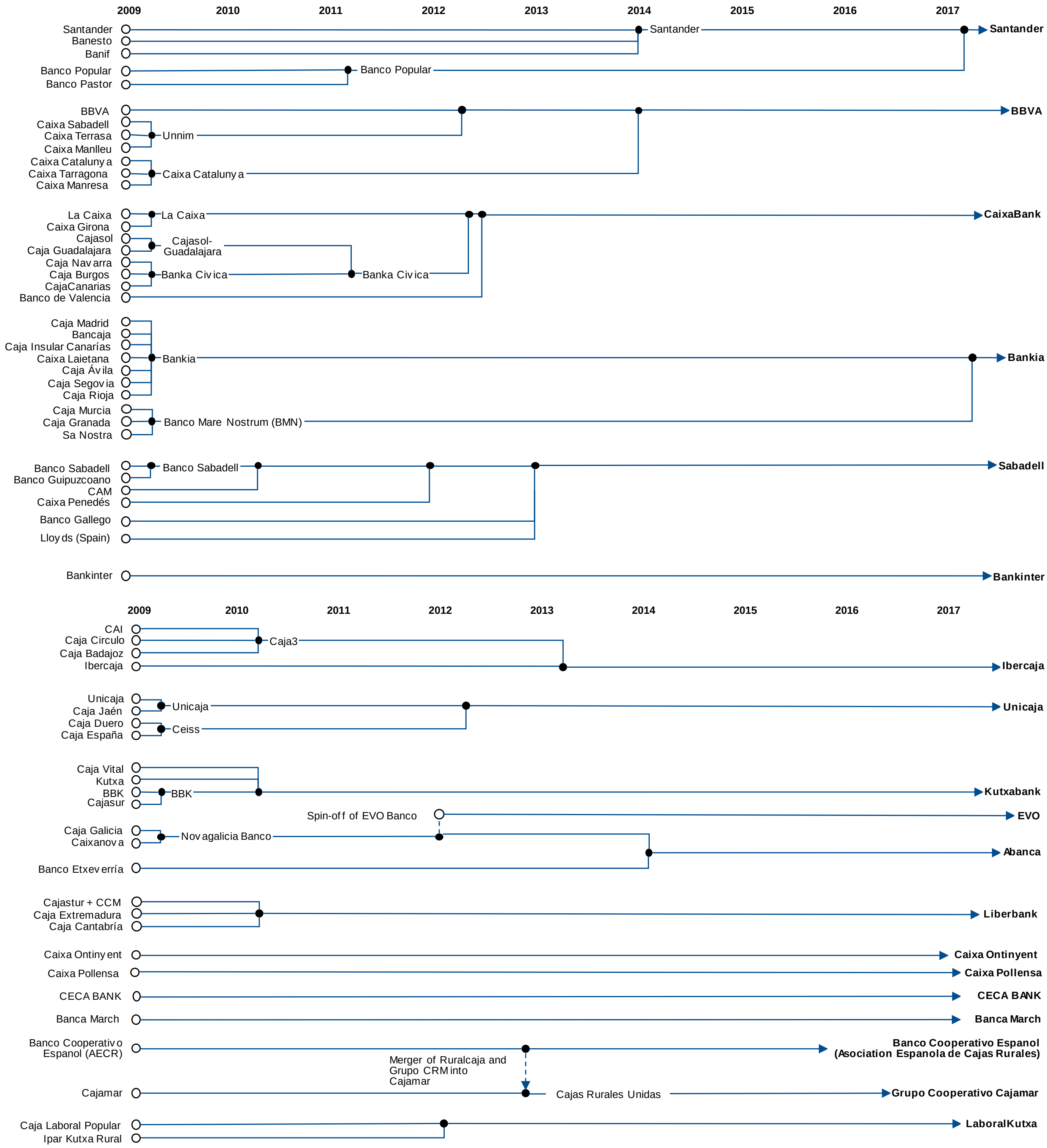
Figure 8: Credit institutions: number of branches per 100,000 bankable inhabitants (2016)



Source: ECB, OECD, IMF, Scope Ratings
Notes: UK data refers to 2014
Bankable inhabitants defined as population over the age of 15.

I. Appendix: The consolidation of Spanish banks

Figure 9: The crisis has materially reduced the number of banks in Spain.



Source: Scope Ratings

Scope Ratings AG

Headquarters Berlin
Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main
Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389-0

Paris
33 rue La Fayette
F-75009 Paris

Phone +33 1 82 88 55 57

London
Suite 301
2 Angel Square
London EC1V 1NY

Phone +44 203-457 0 4444

Madrid
Paseo de la Castellana 95
Edificio Torre Europa
E-28046 Madrid

Phone +34 914 186 973

Milan
Via Paleocapa 7
IT-20121 Milan

Phone +39 02 30315 814

Oslo
Haakon VII's gate 6
N-0161 Oslo

Phone +47 21 62 31 42

info@scoperatings.com
www.scoperatings.com

Disclaimer