Roles, Missions and Business Models of Public Financial Institutions in Europe

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Authors: Mathias Schmit, Laurent Gheeraert, Thierry Denuit, Cédric Warny

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FOREWORD

In Europe, the balance between publicly owned and privately owned financial institutions varies through time and from country to country. Historically, nationalisations and privatisations have moved the balance backwards and forwards. So has the recent financial crisis. Mathias Schmit, Laurent Gheeraert, Thierry Denuit and Cédric Warny from the Solway Brussels School of Economics and Management have carried out a huge research project in which they analyse the roles and missions of financial institutions with public ownership and involvement in 32 European countries. They have published their results in the report: *Public Financial Institutions in Europe,* European Association of Public Banks, Brussels, March 2011.

The authors have kindly offered SUERF to make their main results available to readers of *SUERF Studies*. The SUERF Editorial Board has with gratitude accepted the offer because it gives SUERF readers an opportunity to get a valuable insight into the public financial industry which plays an important role in Europe. The authors construct a unique database of public banks and funding agencies in Europe in which the extent of public-sector involvement is illuminated. In line with the corporate governance literature, they apply both ownership criteria and control criteria to describe the degree of public influence.

They analyse the missions of the institutions in terms of their objectives, geographic scope, stakeholders and products and services. Public financial institutions have been established for a variety of reasons. The authors explain the main rationales for such establishments. Public interest missions differ and this explains the emergence of a variety of business models such as development banks and agencies, export credit agencies, municipal credit institutions and regional development agencies.

It is the authors' goal to provide answers to questions like: Who are the public financial institutions? What do they do? Why do they do it? And how do they do it? In the view of the SUERF Editorial Board, the authors achieve their goal.

On behalf of the SUERF Editorial Board

Morten Balling

Roles, Missions and Business Models of Public Financial Institutions in Europe

Mathias Schmit, Laurent Gheeraert, Thierry Denuit & Cédric Warny

Introduction

Throughout history, the banking sector has been instrumental in enabling economic prosperity. Many public authorities played an active role in the banking sector through the creation of public financial institutions. This public involvement in banking had several key beneficial knock-on effects on the economy. Firstly, it made sure that the lower-middle classes were not denied access to financial services, such as deposits or loans, and thus facilitated the emergence of mass banking services. Secondly, it allowed sizeable investments to be made and paved the way for both private and public (re)construction projects that would not have been feasible without government backing.

However, to our knowledge, little research has been conducted with a view to analysing the roles, missions and business models of public banks and the public financial industry. While many studies have been published regarding public banks, we note that the existing literature tends to focus on comparing and contrasting public and private banks' performance.

Numerous authors – as well as the International Monetary Fund – claim that state-owned banks are characterized by low profits and low cost efficiency, sometimes leading to reduced access to credit (see, for example, La Porta *et al.* (2002), Barth *et al.* (1999), Beck *et al.* (2003)). It has also been argued that state ownership of banks is linked to a higher likelihood of financial crisis (see, for example, Caprio and Martinez Peria (2000) cited in Rudolph (2009)). A negative judgment on the performance of mutual banks and public banks is also provided by Iannotta *et al.* (2008) in a study of the 181 largest banks in 15 European countries, over the period 1999-2004. Similar studies focusing on specific European countries seem to concur fully with these findings (like Hau and Thum (2009) and (Farabullini and Hester (2005). Consequently, most of these authors recommend bank privatization in order to increase operating efficiencies.

It is useful to say a few words about the so-called 'transition countries' (i.e. the former Soviet Union and its allies). As a result of the former communist regimes and their policies, many banks in transition countries are still state-owned. Here too, most authors recommend privatization to increase efficiency. For instance, the findings published by Fries and Taci (2005) tend to prove that state-owned

banks are less cost-efficient than privately owned banks (out of a sample of 15 Eastern European countries), suggesting that private banks (especially those that are foreign-owned) are the most efficient. However, after taking into account deposit insurance, Karas *et al.* (2010) emphasize that this might be due to the fact that better performing public banks were privatized first.

However, an opposite view challenging these findings (or at least their reliability and significance) has also gained support. For instance, drawing on a sample of German banks, Altunbas *et al.* (2001) seem to find that state-owned banks do not underperform, even going so far as to suggest that they might enjoy a small cost and profit advantage over private banks. Other authors are more neutral, concluding that neither underperformance nor overperformance can be established, and suggesting that performance might not be related to ownership structure. As a result, they state that public banks should not necessarily be considered less efficient a priori (Levy-Yeyati *et al.* (2004), Micco *et al.* (2004) for the developed countries). The same holds for the transition countries like shown by the findings of Grigorian and Manole (2006) and Bonin *et al.* (2005) (cited in Karas *et al.* (2010)). Based on a sample of 1999-2002 data on Russian banks, Styrin (2005) also proved that there were no noteworthy correlations between type of ownership and efficiency. From their research on the Croatian financial system, Kraft *et al.* (2006) confirm this last point, suggesting that privatization cannot be linked to systematically better results.

Regarding the underlying rationales explaining the relative performance of public financial institutions, three broad schools can be distinguished. First, the social and development view, according to which public banks are needed to support local and regional activities. Indeed, the purpose of state-owned banks is to develop less profitable sectors that provide significant social benefits to the community where they are located. Consequently, these banks aim to reduce market inefficiencies by developing industries that would have otherwise been left behind. It has also been argued that they help to prevent unfair coalitions of private banks and capital drain, again with a view to improving social welfare. (For a detailed overview of these arguments, see Gerschenkron (1962), Atkinson and Stiglitz (1980), Stiglitz *et al.* (1993), Beck *et al.* (2003), Berger *et al.* (2005), Andrianova *et al.* (2006), Hakenes and Schnabel (2006)).

More recently, some authors have developed what has come to be known as the political view, suggesting that the allocation of resources in public banks is suboptimal because it is a politicized process. Among the supporters of this view, many authors focus on the Italian banking sector. Let us cite, for example, Shleifer and Vishny (1994), Shleifer (1998) and Barca and Trento (1997), according to whom there is evidence of the politicization of resources in Italy, leading to poorer operating performance by state-owned banks. Other examples, such as Ginsborg

(1990), suggest that differences in terms of loans granted to the South and the North of Italy correspond to the disparities in terms of political patronage between these regions. Lastly, Sapienza (2004) sheds light on the political challenges by demonstrating that state-owned banks tend to favour companies with strong political affiliations. Other findings by Cecchetti and Krause (2001) as well as Kane (1977) have pointed out the unfavourable impact of public ownership on monetary policy efficiency and the granting of loans.

The third explanation put forward for the relative performance of public banks is known as the agency view. Supporters of this view suggest that bureaucratization and bribery in public banks are such that they can offset social gains. They argue that public banks are more prone to bureaucratization, agency issues and poorer governance than their private counterparts, leading to some misallocations (see Barnerjee (1997) and Hart *et al.* (1997)).

However, a fundamental issue that arises when trying to assess the validity of these different views is that they all come to the conclusion that public banks are potential underperformers. In our opinion, it is important to stress that performance analysis in economic literature relies mainly on accounting ratios which lead to many analytical pitfalls and are sources of misinterpretations. Furthermore, they do not make it possible to take into account non-financial focus, which is arguably an essential pillar of public banks' objectives. Finally, it should be stressed that comparing only financial performance measures without looking at the wide variety of missions and roles of public banks is highly questionable.

Recognizing the shortcomings of solely focusing of financial performance indicators, we aim to provide a new and broader viewpoint and pertinent added value on the subject. The main goal of this paper is to question the pre-existing definitions of the concept of 'public banks' that is missing in the literature. The next Chapter describes our methodology to provide a workable, cross-border definition of 'partly publicly owned and / or controlled' financial institutions. Chapter 2 aims to give a general overview of the public financial sector in 32 European countries by analysing market share and volume. This overview will enable us to analyse the public financial sector in terms of how much market influence the public authorities have over the financial sector. In Chapter 3, we thoroughly analyse missions and roles, not to confirm or repudiate performance hypotheses, but to find similarities between public financial institutions on various levels: objectives, geographical focus, stakeholders, products and services. This will allow us to classify public financial institutions' missions into major categories. Finally, the main missions of public financial institutions allow us to develop a rigorous description of the main business models of public financial institutions in Europe. These business models are described in Chapter 4.

The objective is thus to provide a better understanding of what the term 'public financial institutions' actually means. This is a complex task considering the huge disparities linked to its loose definition. Our multiplicity of approaches and our methodology enable a new look at the subject, in a manner not yet covered. This could further enrich the debate on public banks and financial institutions and the rationales for their existence, for a fruitful debate can only be initiated when we precisely know what we are talking about. The reader of this report will get an understanding of who are the public financial institutions, what they do, why they exist and how they operate in Europe.

The Authors thank the European Association of Public Banks A.I.S.B.L. (www.eapb.eu) for having commissioned the study "Public Financial Institutions in Europe" to Sagora S.P.R.L.

The European Association of Public Banks represents public banks and funding agencies and their specific tasks at the European level. EAPB has several members from various European countries representing about 100 financial institutions. EAPB members constitute an essential part of the European financial sector, in which they play a decisive role with a market share of approximately 15%, a balance sheet of about EUR 3.500 billion and around 190.000 employees. Members of the EAPB are financial institutions, funding agencies, public banks, associations of public banks and banks with similar interests.

1. METHODOLOGY

1.1. Scope and Definitions

1.1.1. Geographic Scope

The geographic scope of the present study – '*Europe (27+5)*' – should be understood as consisting of 32 countries, namely the 27 countries that have been EU Member States since 1 January 2007, plus Croatia, Macedonia, Norway, Switzerland and Turkey. The study only included institutions that were legally incorporated in one of these countries.

1.1.2. Financial Institutions: Banks and Funding Agencies

For the purpose of our study, the term '*bank*' was defined as *an entity subject to supervision by the national banking supervisor* of one of the aforementioned countries. Since banking regulations can differ substantially between countries, the scope of this definition may vary from one country to another, but the simplification entailed by the above definition was made possible by the existence, for all EEA members (i.e. 28 out of the 32 countries included in the scope of our study[1]), of a single 'European passport' for credit institutions (first introduced by the Second Banking Directive), which enforces the mutual recognition of banking regulations between EEA member countries.

Moreover, all the other countries for which we collected data, except Switzerland, have already launched accession talks with the EU and are thus gradually adopting the '*acquis communautaire*', which has already brought about and will continue to result in enhanced convergence between banking regulations across Europe. Furthermore, for the purposes of the present study, the rules governing the supervision of Swiss banks can be considered equivalent to EU banking regulation, thanks to a continuous 'regulatory dialogue' between the Swiss authorities and the European Commission.

For cross-border financial institutions, regulation is shared between the respective 'home' and 'host' countries. Thus, all cross-border financial institutions are both regulated in the country where they are incorporated and supervised on a consolidated basis at group level (so-called 'home' regulation). Under this framework, branches with no legal personality may operate in a host country whilst being solely supervised by their 'home' supervisor. On the other hand, subsidiaries with a legal personality distinct from that of their owner are supervised by the respective watchdog in the country where they are incorporated (a so-called 'host'

1 The 27 EU Member States plus Norway are the EEA member countries included in the scope of the present study.

supervisor). All banks covered by the present study were assigned to the country where they are incorporated, i.e. on an unconsolidated basis[2]. This unconsolidated treatment of financial institutions offers the additional advantage of being compatible with the definition of 'resident units' as per the European System of Accounts (ESA95), which defines such '*resident units*' as having *"a centre of economic interest on the economic territory of a country"*[3].

The present study also covers additional financial institutions not subject to supervision by national financial supervisory authorities. We refer to these as '*funding agencies*'. To our knowledge, there is no established, simple, single workable definition of this term, and we found no structured reference to such financial institutions in the scientific or business literature we examined. Due to the absence of any legal or academic definition of such agencies, and the inherently varied nature of such bodies, the definition of funding agencies used in the present study is mission-based, thus potentially encompassing entities with articles of association and/or legal forms that may differ substantially.

The different types of funding agencies considered within the framework of our study are defined below, based on current definitions offered by intergovernmental organisations.

a) National and Regional Reconstruction and Development Agency[4]

A non-monetary financial institution controlled by the public sector that is primarily active in equity participations and bond issue subscriptions and awards long-term loans (that are beyond other financial institutions' capability or willingness to provide) in a bid to further national and regional development.

b) Export Credit and Guarantee Agency[5]

An agency in a creditor country that provides guarantees or loans for exports of goods and services.

c) Municipal Credit Agency[6]

A financial cooperative whose member-owners are municipalities or regions and that awards its members collectively guaranteed loans at the lowest possible rates of interest.

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2 Surveying banks on a consolidated basis would have been inappropriate for the study in question because it would have over-represented the public banking sector in countries with sizeable internationally active banking groups, but under-represented its public presence in other countries, serviced mainly by subsidiaries of foreign banking groups (for example, several German and Austrian banking groups have subsidiaries in Ireland and spread throughout Eastern Europe, so adopting a consolidated approach would have led to the over-representation of Germany and Austria and the under-representation of many Eastern European countries and Ireland).

3 See Council Regulation (EC) 2223/96.

4 Based on the OECD and IMF definition of 'development banks'.

5 Based on the OECD and IMF definition of 'export credit agencies'.

6 Based on the definition of 'credit unions' of the European Network of Credit Unions.

Note that the three types of funding agencies considered cover the potential scope of activities of 'special credit institutions' as defined in the EU Commission Understanding (see section 1.5). Therefore, the latter institutions may be classified either as banks or funding agencies, according to the fact they are subordinated to a financial supervisory authority or not.

Once the scope had been clearly defined, both in terms of geographic and institutional coverage, a coherent database can be constructed.

1.2. Creating a database of public banks and funding agencies

1.2.1. Coverage Objectives per Country

To ensure that the database remained of workable size, whilst remaining sufficiently exhaustive, a size threshold was introduced for financial institutions. Drawing on the experience of the EU's recent Sector Inquiry on Retail Banking[7], the present study set out to cover at least 80% of the European banking market as measured by total assets as of 31 December 2009. However, the coverage of individual national markets varied, depending on their concentration. Strongly concentrated markets were analysed up to a higher threshold and less concentrated markets by adopting a lower threshold. The present study was always intended to be at least as exhaustive as the Sector Inquiry on Retail Banking, and if at all possible even more comprehensive. The coverage rates for the different national markets covered by the present study are detailed in the table below.

Table 1 – Coverage of the respective national banking markets

Country	National banking market coverage (% assets) in the EU's Sector Inquiry on Retail Banking	National banking market coverage (% assets) attained in this study
Austria	> 60	> 80
Belgium	> 90	> 90
Bulgaria	N/A	> 90
Croatia	N/A	> 90
Cyprus	> 80	> 90
Czech Republic	> 70	> 80
Denmark	> 80	> 90
Estonia	> 70	> 90
Finland	> 90	> 90
France	> 80	> 80
Germany	> 50	> 80
Greece	> 90	> 90
Hungary	> 80	> 90

[7] See European Commission: COM(2007)33 and IP/06/999.

Table 1 – Coverage of the respective national banking markets *(continued)*

Country	National banking market coverage (% assets) in the EU's Sector Inquiry on Retail Banking	National banking market coverage (% assets) attained in this study
Ireland	> 60	> 90
Italy	> 70	> 70
Latvia	> 50	> 90
Lithuania	> 80	> 90
Luxembourg	> 30	> 90
Macedonia	N/A	> 90
Malta	> 90	> 90
Netherlands	> 90	> 90
Norway	N/A	> 90
Poland	> 70	> 80
Portugal	> 80	> 90
Romania	N/A	> 90
Slovakia	> 80	> 90
Slovenia	> 80	> 90
Spain	> 70	> 80
Sweden	> 90	> 90
Switzerland	N/A	> 70
Turkey	N/A	> 90
United Kingdom	> 80	> 80

The total banking assets covered in the present study derive from statistics published by the European Central Bank (ECB) on Monetary Financial Institutions (MFIs)[8]. These market statistics were compiled in accordance with the European System of Accounts (ESA95), using the unconsolidated definition of 'resident units'. Hence they can be used to measure national market sizes, as well to compute market shares and coverage rates per country.

Unfortunately, such market-coverage-related objectives and corresponding assets totals could not be obtained for funding agencies, since no definition of them existed prior to our study. Accordingly, there was no way of systematically assessing the comprehensiveness with which funding agencies are covered, and other methods (see below) had to be employed to ensure a sufficient degree of exhaustiveness. As no information is available on the size of this particular market, no analysis of the market share of funding agencies was carried out. To focus our analysis on the most significant financial institutions, only those funding agencies with assets of 3 million euro or above (as of 31 December 2009) were included in the dataset.

8 See www.ecb.int/stats/money/aggregates/bsheets/html/index.en.html.

1.2.2. Identifying Banks and Funding Agencies

a) Banks

Various sources of information were used to draw up a list of banking institutions in a given country complying with the coverage criteria outlined above. For highly concentrated countries, or when exhaustive data on institutions' assets were available, national supervisors' lists of supervised entities were used. Whenever necessary, these were complemented by various national bank rankings (based on their asset size) found in the business literature, and national databases providing banking information were cross-checked if need be by conducting interviews with bank executives in the countries included in the survey.

b) Funding Agencies

As pointed out above, no market-size-related or coverage-related criteria could be applied to funding agencies, which threatened to jeopardise the comprehensiveness of the study. To remedy this, the present research used membership lists of various professional organisations to ensure optimal market coverage. The resulting database of funding agencies was further complemented by conducting interviews with bank and funding agency executives in the surveyed countries.

1.2.3. Identifying Public Financial Institutions

a) Two Complementary Criteria: Ownership and Control by a Public Authority

The existing scientific literature offers no comprehensive and authoritative definition of what is meant by the term '*public bank*'. Most studies[9] use some variants of share ownership by public authorities as a criterion for defining public banks, yet neither the nature of such ownership, nor the term 'public authorities' are further defined in the literature.

The present study follows the literature in using *ownership by public authorities* as a first criterion for defining the public character of financial institutions. Consequently, in accordance with International Financial Reporting Standards (IFRS), ownership is defined as the fact of *"holding equity interests of an investor-owned entity"*[10].

However, one possible shortcoming of merely considering the ownership structure of the studied banks is that actual control over management decisions might differ statutorily from ownership, making the criterion of ownership less relevant as an indicator of actual decision-making power in the institutions in question.

9 See, for example, Altunbas, Evans & Molyneux (2001); Micco, Panizza & Yaez (2007).
10 See IFRS glossary.

For this reason, in keeping with IFRS standards, we introduced a second criterion for assessing the public nature of banks, namely control. IAS 27, dealing with "*Consolidated and Separate Financial Statements*", defines control as *"the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities"*[11].

In the most straightforward scenarios, where a 'public authority' directly owns a proportion of a bank's or funding agency's shares with normal voting rights, both criteria can be expected to yield similar results. However, when the ownership and voting rights structures are not identical, or when the banks or funding agencies under consideration are part of a complex ownership chain, the control criterion may offer a different insight from that gained by applying the ownership criterion. For this reason, the following section provides a more explicit account of the treatment of complex ownership and control chains.

Another key term that needs to be clearly defined before public banks can be properly categorised is what we might refer to as '***public authorities***'. For the purposes of the present study, in line with the EU directive on the transparency of financial relations between the Member States and public undertakings[12], public authorities were defined as *"all public authorities, including the State and regional, local and all other territorial authorities"*.

b) Categories of Partly Publicly owned Institutions

We define two main categories of part publicly owned financial institutions.

- ***Public banks*** or ***public funding agencies*** are financial institutions that qualify as 'public undertakings' within the meaning of Directive 2006/111/EC, i.e. banks or funding agencies where public authorities exercise a '*dominant influence*' over the undertaking, meaning that they control over half the voting rights or own over half the shares;
- ***Banks or funding agencies with a public influence*** are financial institutions over which public authorities exercise a sizeable but minority influence, i.e. where the public interest is at least 5% (in terms of either ownership or control). Within this category, we can also identify various levels of public-sector involvement in financial institutions, using analogous interest thresholds to those defined in IFRS consolidation rules for financial statements[13].

Both thresholds used in IAS 27, i.e. 20% and 50%, are consistent with the existing literature on the analysis of control and ownership. As might be expected on the basis of intuition, the 50% mark has been shown to be a theoretically accept-

[11] See IAS 27 "Consolidated and Separate Financial Statements".
[12] See Directive 2006/111/EC.
[13] See IAS 27 "Consolidated and Separate Financial Statements"; IAS 28 "Investment in Associates".

able threshold for effective control. The 20% threshold has been widely used in the literature for assessing control at lower levels of ownership, in keeping with a very influential paper by La Porta *et al.* (2002). The categorisation of **partly publicly owned** (>5% public control) banks and funding agencies used in the present study is set out in the table below.

Table 2 – Control and ownership levels with their corresponding categorisation

Level of ownership and/or control (%)	Overall categorisation	Detailed categorisation
0 – <5	Non-public company	No public involvement
5 – <20	Company with public participation[a]	Minor public participation
20 – <50		Significant public participation
50 – <100	Public company	Strong public influence
100		Fully public

a. In this report, public *participation* is also indifferently referred to as public *involvement*.

It is important to note that for the purposes of the present study, institutions in which public bodies owned less than 5% of the shares were not considered, since they primarily equate to investments on the part of the State.

c) Dealing with Ownership and/or Control Chains

Complex ownership chains make the controlling shareholder hard to identify and at first sight, in the context of our study, make a qualification of public involvement extremely challenging. To resolve this problem, a comprehensive, standardised approach was called for. We opted to deal with ownership and control chains in the same way as Szafarz & Chapelle (2005).

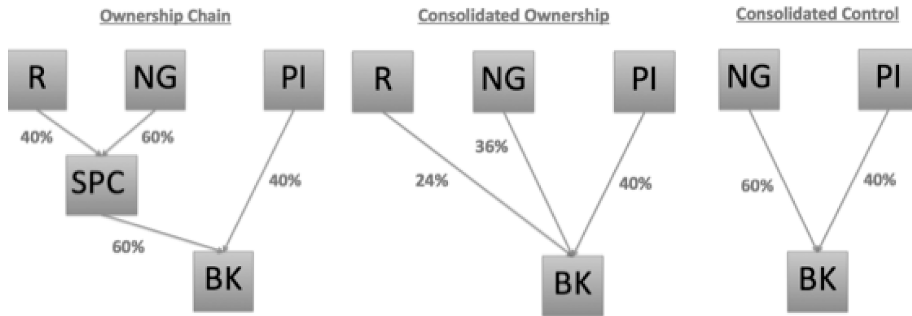
Ownership chains can be dealt with in a relatively straightforward manner. If company A owns a certain stake of x% in company B, which in turn owns a stake of y% in company C, then A's total ownership of C can be calculated as $x*y$.

However, calculations of total *control* are less straightforward. If a company A owns a stake x in company B, which owns a stake y in company C, A's total degree of control over C will depend on whether or not A effectively controls B. If $x > 50\%$, then the A's total degree of control over C will be calculated using the formula $x*y$ and if $x < 50\%$, then A will be assumed not to exert any control over C at all.

An illustration of this methodology is provided below. In this example, the National Government (NG)'s degree of *ownership* of a bank (BK) is calculated by multiplying NG's stake of the 60% ownership of the State Participation Company (SPC) by SPC's ownership stake in BK (60%), yielding a final result of 36%.

Yet using a *control* approach, SPC and NG are fully consolidated because NG owns more than half of SPC's shares (and controls a corresponding proportion of the voting rights). As a result, NG fully controls SPC's 60% stake in BK. In the graph below R and PI are private shareholders.

Figure 1 – Ownership and control chains



To compile a list of banks and funding agencies *with public ownership*, ownership and control structures were examined for each bank and funding agency meeting the scope- and coverage-related criteria. Ownership information was collected from a variety of sources for all banks and funding agencies in our database. The sources in question included the respective financial institutions' websites and annual reports, the specialist business press and interviews conducted with banking executives in the countries included in the survey[14].

1.3. Analysis of Institutions' Missions and Roles

The missions and roles of public banks and funding agencies were collected from mission statements and general business presentations provided by the financial institutions themselves in their annual reports or on their websites. ***Grounded theory*** (see below) was applied to the aforementioned statements in an attempt to produce the most relevant categorisation of the data we had collected. This categorised data was subsequently used throughout the resulting analysis to provide significant insights into the business models, roles and missions of public financial institutions.

[14] In the vast majority of cases, it was reasonable to assume that direct ownership and control coincided. The only source of a potential difference between the extent of public involvement according to ownership as opposed to control criteria, is the effect of ownership and/or control chains.

1.3.1. What Information do Mission Statements Provide?

A mission statement can be defined as *"an enduring statement of purpose that distinguishes one organisation from other similar enterprises, a mission statement is a declaration of an organisation's 'reason for being'."*[15]

This makes mission statements extremely interesting, because they not only provide a clear picture of how banks try to position themselves at a given moment in time, but also enable a dynamic understanding of what these financial institutions are intent on achieving in the long term. Their mission statements also clearly state their commitment to particular causes and objectives and highlight the focus they have chosen, as reflected by the range of products they offer. As Peter Drucker put it in 1973, "*a business is not defined by its name, statutes, or articles of incorporation. It is defined by the business mission. Only a clear definition of the mission and purpose of the organisation makes possible clear and realistic business objectives.*"[16]

Another advantage of using explicit textual mission statements is that they can easily be analysed using Grounded Theory, which produces the best results if used on existing texts, i.e. texts constructed independently of the researcher, thus constituting an optimal basis for unbiased, objective analysis.

However, mission statements also have potential shortcomings. On the one hand, they reflect how an institution views itself, yet there is no way of checking the consistency of such a self-image with how that image is perceived by the outside world. In addition, mission statements cannot be used to check the extent to which a bank or funding agency is actually fulfilling the mission it has supposedly set itself. Another, more limiting shortcoming with respect to our study was the fact that not all the banks included in the data set had produced explicit mission statements. This can be attributed to the fact that the mission statement is, to a large extent, an established management and strategy concept in primarily English-speaking business circles, rather than one that is universally applied in a European context. In an effort to overcome this limitation, general descriptions (which were provided by all banks in the sample) were used to complement mission statements as our primary data source. These descriptions were then complemented by conducting interviews with banking executives in the countries included in the survey.

Based on the components of mission statements identified by David (1989), the present study considers the following broad categories for analysis:

(1) Objectives – What are the bank's broad objectives?

(2) Geographic focus – Where does the bank compete?

[15] See David (1989).
[16] See Drucker (1973).

(3) Stakeholders – Who are the bank's stakeholders?
(4) Products and services – What products and services does the bank offer?

1.3.2. Grounded Theory: how to Analyse Mission Statements

Grounded Theory analysis was used to extract and categorise data from the collected mission statements. Grounded Theory was then applied to the data in the following manner:

a) Initial Sampling

The initial sample consisted of 64 banks (two banks for every country included in the study). Those banks were not chosen arbitrarily, but rather with a view to ensuring the variety and richness of the data. Those data provided basic terms, or 'codes', on which the ensuing analysis was based, i.e. keywords that were identified in the collected texts.

b) Summarising Codes into Concepts

Distinct – but related – codes were then compiled and used to produce concepts, which are lower common denominators than codes and therefore enabled data to be grouped for further analysis. Every code was based on one of the broad categories defined above. The following concepts were identified in our data:

1) Stakeholders:
   a. General public;
   b. Customers;
   c. Shareholders;
   d. SMEs;
   e. Public entities;
   f. Other banks;
   g. Employees;
2) Location:
   a. Regional;
   b. National;
   c. International;
3) Products and services:
   a. Retail banking;
   b. Commercial banking;
   c. Wholesale banking;
   d. Mortgage banking;
   e. Asset management;
   f. Investment banking;
   g. Public banking;
   h. Consulting;

   i. Guarantees and insurance;
   j. Settlement;
   k. Subsidies;
4) Objectives
   a. Job creation;
   b. Economic development;
   c. Financial inclusion;
   d. Sustainable development;
   e. Agriculture;
   f. Tourism industry;
   g. Education;
   h. Infrastructure;
   i. Energy;
   j. Sports and culture;
   k. Pawnshop;
   l. Export promotion;
   m. Innovation.

c) Theoretical Sampling

In the theoretical sampling phase, the categorisation developed above was applied to all mission statements and general descriptions included in the data set. At the same time, the concepts listed above were enriched and further defined by further linking them to new codes.

1.4. Conclusion

One of the key challenges in analysing public financial institutions – if not *the* prime challenge – is to define a clear, homogenous scope for the study. In this respect, one of the major contributions of the present study is its construction of a structured, definition-based, homogenous database of public banks and funding agencies in Europe. The data collection and validation processes relied on a variety of sources, including national supervisors, institutions' websites and annual reports, scientific literature, the specialist business press and last, but not least, a significant number of interviews with banking executives in the countries included in the survey. The extent of public-sector involvement was summarised using both ownership and control criteria, and by applying various thresholds, in line with the scientific literature. The resulting fine categorisation of financial institutions permitted a differentiated analysis of the given degree of public involvement, whilst the structured collection of mission statements allowed us to study the various objectives, roles and functions of public financial institutions and to identify the main business models used by public banks and funding agencies.

2. AN OVERVIEW OF THE EUROPEAN BANKING SECTOR WITH PUBLIC PARTICIPATION

2.1. Introduction

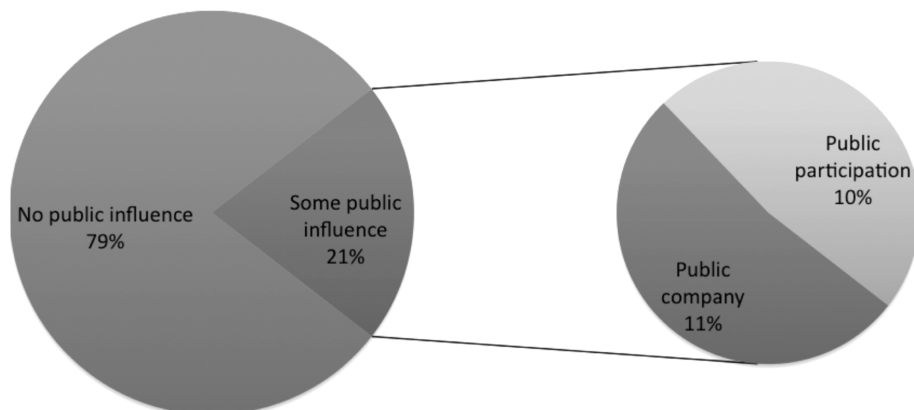
This chapter provides a descriptive analysis of the European partly publicly owned financial sector. It also explores patterns of public authorities' influence over the financial sector, though it stops short of actually investigating their respective roles and missions, which will be covered in the following chapter. The originality of this chapter lies in the scope and comprehensiveness of our study, for whereas most previous studies of public banking were narrower, either in their geographic scope or regarding the types of banks with public participation under consideration, our study covers a large span of countries – 32 – of the continent and all types of partly publicly owned financial institutions, including funding agencies. Moreover, whereas other studies tend to rely on a binary distinction between 'public' (i.e. publicly controlled) and 'non-public' (privately controlled) banks, our approach entails viewing the spectrum of public influence as more of a continuous spectrum.

Our database numbers no fewer than 221 banks and 81 funding agencies in Europe that are subject to varying degrees of public influence. The associated financial sector assets amount to € 9,883 billion – 21% of total assets of the financial sector[17] – with 52% of this total pertaining to public companies (≥ 50% public control) and 48% to companies not controlled by public authorities (5-49.99% public control). Our examination of the spectrum of public influence was further refined by distinguishing between fully public companies (100% public control) and companies subject to strong public-sector influence (50-99.99%), and also by drawing a distinction between significant public-sector involvement (a 20-49.99% public participation) and minor public involvement (a 5-19.99% public participation).

At the same time, our study does not include previously private banks recapitalised by public authorities through equity subscription during the financial crisis. This excluded category amounts to 14 banks managing assets worth € 4,375 billion, equivalent to 9% of total European financial assets.

[17] Total asset of the European financial sector is defined as the total assets under management of all banks (with and without public control) and all funding agencies (which are all subject to a certain public involvement) in "Europe 27+5", as of 31 December 2009. Note that the four identified pan-European multilateral development banks, totalling ? 408 bn, are not included in our total market size. Given the coverage objectives used in each country for identifying the list of institutions with public participation (*cf.* methodology outlined in Chapter 3), market shares (as a part of a country's total assets) represent, therefore, a *minimum* market share of partly publicly owned financial institutions.

Figure 2 – Public-sector influence in the European financial sector (as a percentage of total assets in "Europe 27+5")



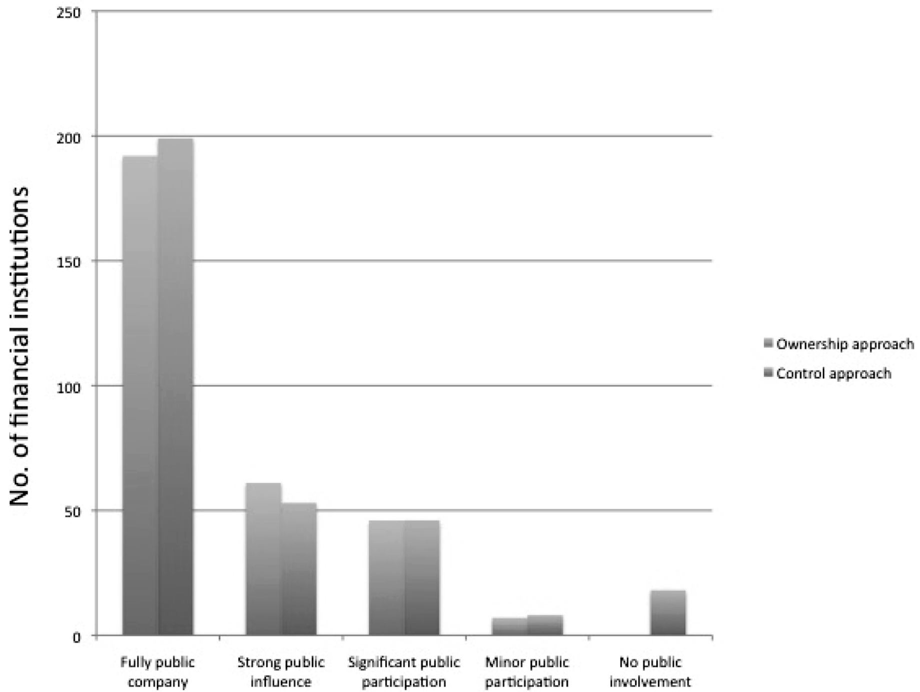
Source: Elaborated by the Authors.

Bailed-out banks were excluded from the scope of the present study since our prime objective was to ascertain the roles and missions of financial institutions that are subject to long-term public influence. Formerly private entities that were only recently nationalised or benefited from public capital lifelines did not fit the bill, either because only short-term measures were involved or because the changes were too recent for the mission of the affected entities to have already readjusted to their new status as publicly controlled bodies.

As indicated above, existing studies in this domain usually define public banks in terms of their level of public ownership. To provide a more detailed and more accurate description of the real level of involvement of public authorities in the banking system, the present study favoured a 'control approach', in line with IFRS accounting standards.

The graph below contrasts so-called 'ownership' and 'control' approaches applied to our sample of European financial institutions, based on the methodology set out in Chapter 3. Defining public banks in terms of control rather than ownership actually accentuates the patterns of public-sector influence. Consequently, some financial institutions previously categorised as companies subject to strong public control (50-99.99%) now qualify as fully public companies (100% control). The 7 institutions switching categories from 'subject to strong public influence' to 'fully public company' control combined assets worth € 46 billion.

Figure 3 – Contrasting the 'control' and 'ownership' approaches



Source: Elaborated by the Authors.

On the other hand, some institutions falling into the 'significant public participation' category under the ownership approach emerge under the control approach as institutions with only minor or even no public involvement. In all, 14 financial institutions (controlling assets worth € 711 billion, representing almost 21% of the total for institutions subject to significant public participation) switch from the 'significant' to either the 'minor' public participation category or to 'no public involvement' category, whereas 6 financial institutions (controlling assets totalling € 50 billion) switch from the 'minor public participation' to 'no public involvement' category.

Table 3 – Contrasting the 'control' and 'ownership' approaches

		Control approach					
	Assets (€bn)	Fully public company	Strong public influence	Significant public participation	Minor public participation	No public involvement	Total (€bn)
Ownership approach	Fully public company	100.0%	0.0%	0.0%	0.0%	0.0%	4,197
	Strong public influence	3.5%	96.3%	0.1%	0.0%	0.0%	1,299
	Significant public participation	0.0%	0.0%	82.7%	0.7%	16.6%	4,106
	Minor public participation	0.0%	0.0%	0.3%	89.3%	10.3%	1,414
	Total (€bn)	4,243	1,252	3,402	1,291	830	11,017

Source: Elaborated by the Authors. The table indicates the share of assets that migrated from one level of public influence to another as a percentage of the total assets under the ownership approach to the control approach. For instance, 3.5% of the total assets which under the ownership approach were under strong public influence have migrated to a 'fully public company' under the control approach.

Generally speaking, these changes can be explained by the fact that the more discriminating control approach leads to a more strongly dichotomised classification. The more discriminating control criteria used in our study (as opposed to the more traditional ownership criteria) offer the advantage of contrasting two radically different sets of public financial institutions: on the one hand those subject to public control, which constitute part of a focussed strategy by the authorities to fill specific gaps in the market left by private companies, and on the other hand institutions with public participation in which the authorities retain a residual stake, either for historic reasons or as an investment.

2.2. An Overview of the European Financial Sector with Public Participation

Note that the figures in the table overleaf were computed on a non-consolidated basis i.e. based on the assets of locally incorporated legal entities. For instance, the assets of a foreign-owned local subsidiary are those of the subsidiary only; similarly, the assets of the mother company do not take into account the assets of its subsidiaries.

Two important remarks should be kept in mind while examining the overleaf table:

- In the United Kingdom, one bank, Barclays, is remarkable for accounting for a very large share of European banking assets subject to significant public participation and 17% of the UK's total banking assets. However, the reason for such a high level of public participation is the significant stake in Barclays' capital owned by the Qatari government. If this Qatari shareholding was ignored under the assumption that the Qatari government is not out

Table 4 – An overview of the European financial sector with public participation
Source: Authors' elaboration

Country	Coverage rate (%) (1)	Total assets (€bn) (2)	Public company						Company with public participation					
			Fully public company (5)			Company subject to strong public influence (5)			Significant public participation (5)			Minor public participation (5)		
			No. of banks (3)	No. of FA (4)	Mkt share (%) (6)	No. of banks (3)	No. of FA (4)	Mkt share (%) (6)	No. of banks (3)	No. of FA (4)	Mkt share (%) (6)	No. of banks (3)	No. of FA (4)	Mkt share (%) (6)
Austria	>80	1,083	9	1	6.9	6	0	2.6	2	0	0.2	0	0	0.0
Belgium	>90	1,291	1	5	0.1	1	1	0.6	1	1	19.7	0	0	0.0
Bulgaria	>90	37	1	1	1.8	1	0	1.3	0	0	0.0	0	0	0.0
Croatia	>90	57	2	2	14.6	1	0	3.4	1	0	0.7	1	0	0.3
Cyprus	>90	124	0	0	0.0	0	0	0.0	0	0	0.0	0	0	0.0
Czech Republic	>80	156	1	1	1.2	1	0	1.5	0	0	0.0	1	0	1.1
Denmark	>90	1,066	0	2	1.9	0	0	0.0	0	1	1.1	2	0	2.2
Estonia	>90	22	0	1	0.9	0	0	0.0	0	0	0.0	0	0	0.0
Finland	>90	426	1	2	9.2	0	0	0.0	0	0	0.0	0	0	0.0
France	>80	8,102	21	2	4.2	3	0	0.0	0	0	0.0	1	0	15.3
Germany	>80	8,562	39	5	23.9	3	0	9.0	1	0	0.0	1	0	0.0
Greece	>90	459	0	1	n.a.	2	0	8.3	1	0	3.9	0	0	0.0
Hungary	>90	127	0	3	4.0	1	0	7.1	0	0	0.0	0	0	0.0
Ireland	>90	1,755	6	0	11.7	1	0	10.7	0	0	0.0	0	0	0.0
Italy	>70	3,933	0	14	6.0	2	8	0.1	1	0	0.0	0	0	0.0
Latvia	>90	32	1	0	3.9	0	0	0.0	0	0	0.0	0	0	0.0
Lithuania	>90	26	0	0	0.0	0	0	0.0	0	0	0.0	0	0	0.0
Luxembourg	>90	1,259	4	0	5.7	0	0	0.0	2	0	7.5	0	0	0.0
Macedonia	>90	5	1	0	1.0	0	0	0.0	2	0	4.3	1	0	4.0
Malta	>90	44	0	0	0.0	0	0	0.0	1	0	14.0	0	0	0.0
Netherlands	>90	2,310	2	1	6.9	0	0	0.0	0	0	0.0	0	0	0.0
Norway	>90	499	0	5	5.6	1	0	5.7	1	0	35.4	0	1	5.4
Poland	>80	252	3	1	3.3	2	0	16.0	2	0	2.9	0	0	0.0
Portugal	>90	484	3	0	23.5	0	0	0.0	0	0	0.0	0	0	0.0
Romania	>90	83	1	0	5.9	2	0	1.4	0	0	0.0	0	0	0.0
Slovakia	>90	57	1	3	1.6	0	0	0.0	0	0	0.0	0	0	0.0
Slovenia	>90	50	3	9	8.7	1	0	9.1	2	0	40.2	0	0	0.0
Spain	>80	3,425	1	5	1.9	0	1	n.a.	24	0	32.9	0	0	0.0
Sweden	>90	923	3	2	5.9	0	0	0.0	1	0	12.8	0	0	0.0
Switzerland	>70	818	19	1	22.5	12	0	11.6	1	0	1.2	0	0	0.0
Turkey	>90	330	4	0	34.3	3	0	9.6	0	0	0.0	0	0	0.0
United Kingdom	>80	9,264	0	1	0.0	0	0	0.0	1	0	16.7	0	0	0.0
Total		47,060	127	68	8.1	43	10	2.7	44	2	7.2	7	1	2.7

Note 1. 'Coverage rate' is the ratio of the assets of the banks surveyed to constitute our initial database divided by total assets of the financial sector per country

Note 2. 'Assets' means total banking assets for that country, whether held by public or non public entities

Note 3. 'Banks' are entities with a banking license in the country

Note 4. 'FA' stands for 'Funding Agencies' as defined in the Methodology Section

Note 5. Under the control approach, the label 'Fully public company' applies to financial institutions 100% under public control; 'Company subject to strong public influence' means 50-100% public control; 'Significant public participation' means 20-50% public control; 'Minor public participation' means 5-20% public control; 'No public involvement' means 0-5%

Note 6. 'Market share' is the ratio of assets under a given degree of public influence divided by total assets of the financial sector per country

to mitigate a market failure, Barclays would not be considered a bank with significant public participation.

- Among banks with ‘minor public participation’, France dominates, with € 1,234 billion of assets subject to minor public participation (78% of the total in this category for Europe as a whole), equivalent to 16% of the French banking sector as a whole. Yet this is exclusively due to the Belgian government’s involvement through the Société Fédérale de Participations et d’Investissements in BNP Paribas, a leading global bank, following the bail-out of the Belgian bank Fortis, subsequently acquired by BNP Paribas[18]. As such, the significance of the ‘minor public participation’ in France, in the framework of the present study, should not be overrated. Only Romania, and to a lesser extent Slovenia, have a high level of ‘minor public participation’ in their domestic financial industries. Naturally, such low-level involvement does not yield governments any decisive degree of control over the companies in question, and as such it may be interpreted as signalling a desire for a broadly ranging presence in the banking sector to contribute to help finance the economy at large.

To show that the patterns of public involvement in the European financial sector are greatly varied, the graph below plots ‘Europe 27+5’ countries in function of their partly publicly owned market share and the number of institutions constituting that market share, with the axes crossing at the European averages. This graph not only hints at the different ways of organizing the markets among European countries but also informs on the average sizes of the institutions with public participation. (See Figure 4, p. 28)

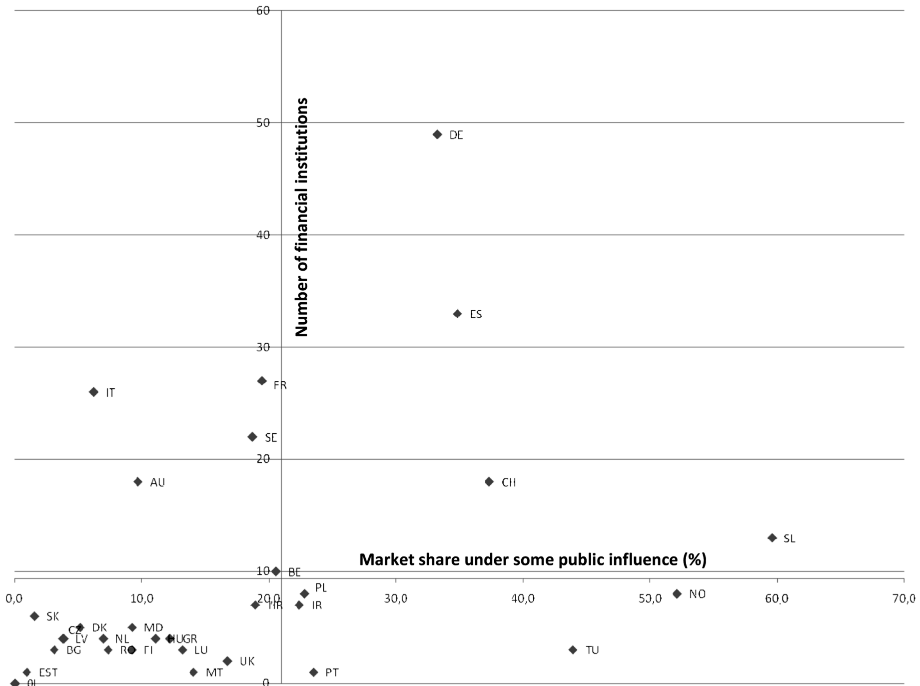
On the one hand, there are countries whose market share under public influence is attained by a great number of companies, meaning that public involvement is spread among many entities (e.g., Germany, Spain, Switzerland, Italy), whereas on the other hand we find countries whose partly publicly owned market share is attained by a few number of entities (e.g., Turkey, Norway, Portugal).

For instance, Turkey, with only 4 banks under full public control already covers 44% of the domestic banking market, whereas the 44 fully public German financial institutions (mostly banks and five funding agencies) cover 24% of the German banking sector’s total assets[19].

[18] In this case, BNP Paribas’s control structure has been impacted indirectly by the financial crisis, through the buyout of bailed-out bank, i.e. Fortis Bank.

[19] Note that there are 431 *Sparkassen* in Germany totaling € 1,073 bn of assets, amounting to a total market share of approximately 15%. In line with the average threshold we defined (80% market coverage), our database does not include small financial institutions with tiny market shares. In particular, our database overlooked many German savings banks (*Sparkassen*) due to their very small size. Only the *Sparkassen* large enough to pass the 80% coverage criterion are included in our database.

Figure 4 – Patterns of public involvement in the European financial sector



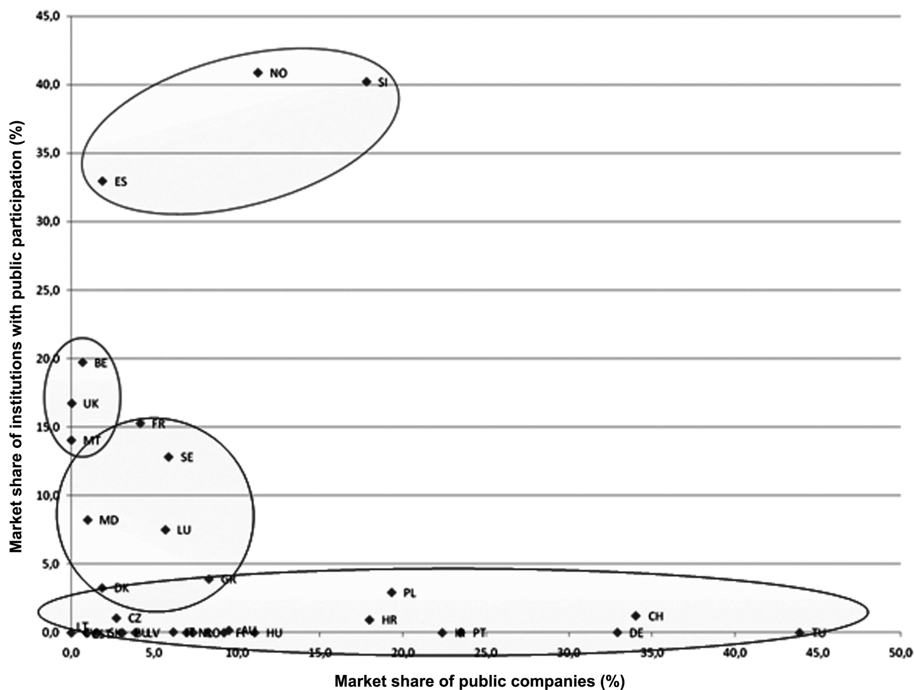
Source: Elaborated by the Authors.

Furthermore, one can have high concentration but over an under-average partly publicly owned market share (e.g. Eastern-European countries) or over an above-average partly publicly owned market share (e.g., Turkey, Norway). Similarly, we find that Germany, Spain or Switzerland are characterized by a low concentration on an above-average market share, whereas Italy also has a low concentration but on a less significant market share.

2.3. Degrees of Public Influence

When assessing the various levels of involvement in the banking industry by European public authorities, it is interesting to try and ascertain whether or not there is any link between how broadly a government is involved (as reflected by the market share covered of institutions subject to varying degrees of public influence) and how strong such involvement is (as measured by the level of effective control exercised by the authorities in question). To this end, the positions of European countries are plotted as a function of, on the one hand, the market share of the public institutions (≥ 50% control) and, on the other hand, the market share of the institutions with public participation (< 50% control).

Figure 5 – Levels of public involvement in the European financial industry



Source: Elaborated by the Authors

As we see, four distinct models for public authorities' involvement in the financial industry seem to emerge.

The first model, adopted by Malta, the United Kingdom and Belgium, entails public authorities exerting diffuse influence over a significant portion of an otherwise privately controlled banking sector, though it should be remembered that the market share subject to this diffuse level of public influence in the United Kingdom is exclusively due to Barclays, whose share of public control is in turn attributable to the shareholding owned by the Qatari government. Bank of Valetta is the only institution subject to such a low level of influence by the Maltese authorities. In Belgium, the public sector has a significant participation into two companies representing 20% of the Belgian banking sector. This is mainly due to Dexia, in which the French State has a 12% stake.

A second model, seemingly embraced by Norway, Slovenia and Spain, entails complementing diffuse control over broad swathes of the financial sector with a strong public presence in key financial institutions that fulfil specific missions. Slovenia's only bank with (significant) public participation commands a national market share of 29%. In Norway, the leading bank with a non-controlling public

involvement is DnB NOR, which is characterised by an extensive international outreach and a broad range of services. It is notable that a single Norwegian bank with significant public participation, namely DnB NOR, holds as much as 45% of domestic assets. On the other hand, the Norwegian government fully controls various special-purpose entities, such as the Norwegian State Educational Loan Fund (SLU), the Norwegian Guarantee Institute for Export Credits (GIEK) and Innovation Norway, a government-led financial assistance programme designed to foster innovative business projects.

In Spain, a noteworthy fact is that the public sector involvement in banking takes the form of strong public influence in the country's *cajas*. Those account for a combined total of 33% of the Spanish banking sector and are incorporated under a cooperative governance system whereby the main stakeholders (including municipalities, employees, depositors, and founders) exercise control over the bank. In fact, the degree of public control resulting from this organisational structure oftentimes totals around 50%. However, since the *cajas* are organized in foundations and have a strong tradition of independence, we consider that the public sector, although theoretically holding a controlling shareholding, merely exercises a significant public influence.

A third model, apparently adopted by France, Sweden, Greece, Luxembourg, Macedonia and Denmark, closely resembles the aforementioned model favoured by Norway and Slovenia, but is greatly diluted, since both the authorities' diffuse and concentrated presence in the banking sector cover smaller fractions of the market.

France's fully public companies are almost exclusively so-called 'municipal credit banks'. Although France numbers 15 such entities, they only account for a negligible percentage of the banking industry due to their small size and predominantly local scope. What drastically increases the share of (full) public control in banking in France is the Banque Postale and the Caisse des Dépôts et Consignations (CDC), respectively totalling € 171 billion and € 104 billion of assets. CDC is a funding agency under direct parliamentary control and active mostly in public banking (managing savings and pension funds, financing cities or universities, serving as a vehicle for strategic long-term government investments, etc.) but also involved in commercial undertakings through its subsidiaries.

In Sweden, a strong public presence is maintained primarily in financing municipalities, this activity being centralised by Kommuninvest, and in the provision of long-term funding for export industries (exports account for almost half of Sweden's GNP). The 13% market share subject to (minor) public participation is due to the presence of Nordea, the Stockholm-based financial services group operating principally in the Nordic and Baltic countries.

Greece's two public companies serve specific purposes: the Export Credit Insurance Organisation (ECIO) strives to facilitate exports, while the Agricultural Bank of Greece (which is one of the smallest financial institutions in Greece) concentrates on the primary sector, though it is currently modernising itself and expanding its scope.

A fourth apparent model, adopted by most of the countries in our sample, aims to ensure public control over a few key financial institutions, which by virtue of the services they propose fulfil specific missions in the national banking market. That said, this strong influence can significantly vary in scope from one country to another (namely from 1% of the domestic market in Estonia to 44% in Turkey). On the other hand, the countries implementing this model are characterised by an almost total lack of any diffuse public-sector involvement in the financial industry. A notable proportion of Eastern European countries, including Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Macedonia and Romania display this degree of involvement. Poland would also belong to this group, but displays a greater share of banks subject to strong public influence, thanks mainly to Bank Gospodarstwa Krajowego, a Warsaw-based state development bank specialising in servicing and financing enterprises, local government entities and regional development projects (including financing of infrastructure and support of EU programs), and also to PKO Bank Polski, a former major state-controlled bank undergoing privatisation, having been floated in 2009 but in which the government retains a controlling stake of 51%.

Switzerland also appears to belong to that fourth model. However, it should be borne in mind that Switzerland is characterised by unusually intensive activity in the private banking and asset management sectors, both of which are rather estranged from the public sector, so it could be argued that the extent of public involvement in banking in Switzerland is underestimated. If the levels of public-sector involvement by European countries in their banking industry were adjusted in terms of their ratio of total banking assets to GNP, the Swiss authorities' level of strong involvement in the banking sector would appear significantly higher.

Finally, we did not find any partly publicly owned financial institutions in two countries covered by our study, namely, Cyprus and Lithuania.

2.4. Conclusion

Our study finds that 21% of the financial industry in Europe is subject to public involvement. The patterns of this public involvement in turn is greatly varied across European countries, with a large dispersion around the 21% mean, as well as great differences in the degrees of public influence, the market shares and concentrations.

The originality of our approach lies in our taking account of the *actual* level of control exercised by the public sector instead of just the level of ownership and our examination of a more continuous spectrum of public influence, ranging from full public control (39% of the market under public influence), to public control (13%), significant public participation (34%) and minor public participation (13%).

Our database, including 221 banks and 81 funding agencies, reveals that the public banking sector in Europe spans a continuum of situations, with clusters of countries adopting distinctive models surfacing. Germany, Spain and Switzerland are conspicuously similar in how they structure their public involvement, as characterised by their networks of regional entities: *Landesbanken* in Germany, *cajas* in Spain and cantonal banks in Switzerland. The relatively high number of such entities spotlights the local embeddedness of their respective banking industry, due to historical decentralisation in the three countries concerned.

The United Kingdom stands out starkly among European nations as a country with relatively little government intervention in the banking industry, the exception being the Barclays Group, due to the Qatari share in its capital mentioned above. And if we bear in mind that most public banks in Ireland are subsidiaries of large German institutions and accordingly leave them out of the reckoning, the share of the Irish banking sector subject to public-sector influence drops drastically. So the existence of a more general 'Anglo-Saxon model' of public involvement in banking could be posited.

The Nordic countries differ markedly from other European countries in the substantial share of their banking sector in which their public authorities have a significant level of participation (20-49.99%). In reality, though, this situation actually turns out to be attributable to just two very sizeable outfits, namely Nordea in Sweden and DnB NOR in Norway. Otherwise Nordic countries interestingly exercise a rather low level of public-sector involvement in the banking sector. An additional peculiarity of Nordic public banks is the importance of municipal credit institutions and promotional institutions which are funding agencies that provide loans and guarantees to facilitate exports and finance SMEs.

Finally, we note that most Central and Eastern European countries adopt a model of public-sector involvement in the banking sector that aims to project a strong influence over a few financial institutions with a specific focus. However, these financial institutions seldom constitute a large proportion of the overall banking market, except in Poland.

3. Overview of Public Financial Institutions' Missions and Roles

The objective of the present section is to provide an overview and discussion of the typical missions performed by European financial institutions with public participation. Starting from an analysis of mission statements, we identify and define four broad categories of missions. Our results show that the level of public-sector participation is linked with the overall financial institutions' missions. We then explore, per mission category, the underpinning theoretical rationales explaining why partly publicly owned financial institutions take up such roles, and illustrate the diverse practical forms these roles can take.

3.1. Mission Categories and Level of Public Participation

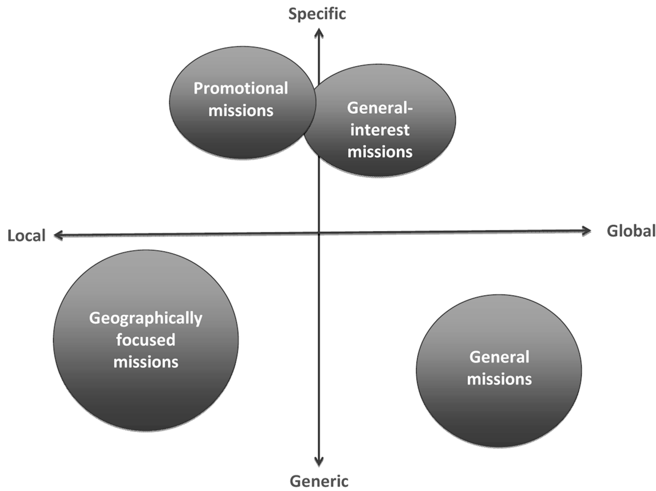
Financial institutions with public participation fulfil a wide variety of missions, as evidenced by the many topics encountered in our review of mission statements. Based on annual reports and websites of the banks composing our database, we categorised mission statements according to four major components identified by David (1989) as described in Chapter 3:

- Objectives – What are the bank's broad objectives?
- Geographic focus – Where does the bank compete?
- Stakeholders – Who are the bank's stakeholders?
- Products and services – What products and services does the bank offer?

Relying on a so-called 'attraction-repulsion' analysis[20] complemented with interviews conducted with professionals of the European financial industry, we distinguish two main dimensions discriminating the missions. These two dimensions are firstly the degree of specificity in the objective of the mission and secondly the targeted geographic scope of the financial institution. Along these two dimensions, as shown on Figure 6, four categories of missions have been defined: promotional missions, general-interest missions, geographically focussed missions and general missions. These analyses have been carried out for the public financial institutions (≥ 50% of public control) on the one hand and the institutions with public-sector participation (< 50% of public control) on the other hand. The results of the mission collection are reported per category in Table 5 provided at the end of this chapter.

[20] Attraction-repulsion analysis compares the theoretical and actual numbers of entities fulfilling a specified mission and the degree of public control over them. Such an analysis reveals whether the mission in question, relatively speaking,'attracts' or 'repels' a particular category of financial entity with reference to set thresholds. This, in turn, can show up the existence of 'biases'.

Figure 6 – General categories of the missions of financial institutions with public participation



Source: Elaborated by the Authors

3.1.1. Public Financial Institutions

Our analyses highlighted that, among public financial institutions (≥ 50% of public control), three main types of missions ('promotional', 'general interest', and 'geographic focus') emerged:

a) promotional missions: These missions are highly specialised and precise in their objectives. Generally, the names of the entities pursuing this kind of missions reflect their purpose (including names such as Pawnshop, Export, Housing, Land, Guarantee, or Development, among others), as opposed to some brand or other proper noun. These entities were also found to be more likely to have a national geographic scope. They aim to fill market gaps left by private financial institutions. Development banks are a prominent example of public financial institutions with promotional missions;

b) general-interest missions: These missions focus either on investing in socially valuable but financially non-profitable ventures or on compensating the private sector's short sightedness by funding long-term investments. These objectives are aimed at complementing traditional market financing in promoting socially desirable outcomes;

c) geographically-focussed missions: These missions convey the objective of serving a specific geographic area. For example, entities coping with these geographic oriented missions are 'municipal credit banks in France, cantonal banks in Switzerland, *Hypo banks* in Austria and German *Landesbanken* (regional banks) and *Sparkassen* (local savings banks).

3.1.2. Institutions with Public-Sector Participation

Financial institutions in which public authorities own a non-controlling stake are widely characterised by their engagement in 'universal banking activities' on a national scope and showing a greater proclivity for internationalisation. Often consisting of sizeable banking groups with local subsidiaries in neighbouring countries, such as banks with a pan-Scandinavian scope, Austrian banks that have expanded eastwards or German banks that are becoming involved in the Benelux countries or in France.

The purpose of the following sections is to further refine the characteristic missions of these major categories of partly publicly owned financial institutions, from both a theoretical and an empirical angle. For each mission category, we study the rationales as to why institutions with public participation do perform such roles. We then analyse the main practical features of institutions in each mission category, not only in terms of their stated objectives and geographic scope, but also in terms their key stakeholders and the products and services they offer.

3.2. Promotional Missions

3.2.1. Rationale

Promotional missions focus on market insufficiencies and thus attempt both to manage and mitigate specific risks, and to overcome information asymmetries.

a) Managing and Mitigating Specific Risks

In general, insurance companies offer their clients protection against risks, bearing the ensuing costs arising when a hazard materialises. They can afford to do this by diversifying their insurance portfolio. However, when diversification is not a possibility they will shun the risk and avoid covering it. A typical example of risk that a private insurance company can hardly cover is an export risk, since such a risk often does not readily permit diversification (usually, export companies have trade flows concentrated on a limited number of countries and clients, and therefore are all prone to the same kind of underlying risks). Of course, this will depend on the diversification of the domestic export industry itself. In a country with a highly diversified portfolio of clients, private insurance companies are more likely to be present. Otherwise, promotional banks have to step in to support exports.

In the banking sector, the emergence of systemic risk appears to be a main potential negative externality in banking sector development. Indeed, the maturity mismatch between assets and liabilities in banks, on which their business model is

based, creates an inherent bias toward illiquidity and makes banks particularly vulnerable to self-fulfilling bank runs and widespread bank failures. Moreover, the principle of limited liability and the fact that in most private banks management and ownership are separate creates a bias toward risk-taking by their managers. Consequently, it is crucial to exercise a certain level of control over risk-taking in the context of banks' investment-related activities. In this connection, public banks may help to mitigate the level of risk in the banking system by being more committed to providing the citizens with incentives to invest in low-risk financial products.

b) Overcoming Information Asymmetries

Banking activities per se are highly information-intensive. As Stiglitz (1993) pointed out, "*information is, in a fundamental sense, a public good. Information possesses […] the two fundamental features of a pure public good, [namely] non-rivalrous consumption (the consumption of the good by one individual does not detract from that of another) and non-excludability (it is impossible, or at least very costly, to exclude anyone from enjoying the public good).*" Furthermore, information entails fixed acquisition costs, since spending on information does not increase with the amount of lending.

When a demand for funds originates from sectors or ventures about which the banker knows little, like agriculture, innovation projects or SME financing (Rudolph, 2009), credit rationing or adverse selection quickly materialises. When faced with a high level of uncertainty, bankers will simply tend either to stop lending or to raise interest rates on all their lending activities and thereby run the risk of attracting more bad borrowers. Public banks, by underwriting these risks and uncertainties, can promote economic development.

Another example of information asymmetry that some public financial institutions seek to overcome occurs when small, and thus relatively unknown, entities need to gain access to market financing. Since information has fixed acquisition costs, private investors are unwilling to lend to these entities. Therefore, the strategy devised by these entities (which may be municipalities, regional authorities or small public financial institutions) is to team up to attain the 'critical mass' needed to attract market financing. This allows financial investors to spread the fixed cost of information acquisition between a larger number of entities. At the same time, this pooling strategy opens up the way for major potential economies of scale.

3.2.2. Examples across Europe

Beyond contributing to economic development at large, special-purpose public financial institutions cover a very wide variety of specific missions. Generally, such institutions address market insufficiencies, such as the financing of SMEs, the promotion of exports and the fostering of innovation.

Originally, promotional institutions were set up in the aftermath of the Second World War to channel Marshall Plan funds towards the reconstruction of European industry. Later on, those institutions that did not go down the path towards privatisation expanded into other domains and developed alternative forms of financing. In 2002, an important decision of the DG Competition of the European Commission[21] made it plain that promotional institutions should primarily aim to mitigate market insufficiencies and cooperate with the private sector, rather than competing with it. The promotional mission of mitigating market insufficiencies is further reflected in a strong propensity to offer investment banking services including venture capital, guarantees, subsidies and consulting services).

By supporting economic development and job creation, banks with promotional missions fill a gap in the economy by financing projects that commercial companies disregard for various reasons, in particular when SMEs are involved. Accounting for 99% of existing enterprises in Europe and, as such, constituting the backbone of most economies, SMEs play a crucial role in economic development and are responsible for creating a significant share of new jobs[22]. Despite this, in most countries, SMEs are underserved by financial markets. Generally speaking, the literature seems to attribute this 'financing gap' issue to either a lack of collateral or a lack of information. A major problem seems to lie in the high fixed overheads of commercial financial institutions, which make it unprofitable for them to pay attention to small entities like SMEs.

By assuming these costs and underwriting these risks, public financial institutions with a promotional mission can promote the development of the local economy. For example, Finland's Finnvera's activities are meant to *"focus on rectifying shortcomings in the availability of financial services"*[23].

Accordingly, innovation emerges as a major preoccupation of governments, which closely relates to their support of SMEs. Indeed, various studies have established that SMEs are 'seedbeds of innovation'. *"In advanced countries, SMEs*

[21] See European Commission, "Understanding about the orientation of legally independent special credit institutions in Germany", 1st March 2002.

[22] Some economists criticise this evidence, though, for not taking account of the *net* creation of jobs, claiming that SMEs may also be responsible for most 'job destruction'. Nonetheless, there remains a strong economic case for arguing that government subsidies provided to SMEs foster job creation.

[23] See Act on Credits and Guarantees Provided by the State-Owned Specialised Financing Company, 18 June 1998 (445/1998).

appear to contribute more than their share of innovations, particularly when one considers their superior ability to move innovations into the marketplace"[24]. More generally, innovation supposedly entails high risks insofar as the associated research is basically a cost that could potentially generate no gains. Sometimes, even if the research does prove successful, there is no way of privatising a sufficient share of the social benefits derived from the innovation in question. Such considerations may harm private companies' investment in innovation and go some way towards explaining why fundamental research is usually funded by governments and why public research and development centres are subsidised through public financial institutions.

Innovation Norway is a prominent example of a public company emphasising support to innovative companies. According to its objects clause, Innovation Norway is to be the *"backer and promoter of entrepreneurs, newly-founded and small and medium-sized enterprises (SMEs) that seek to grow, as a rule in an international market. The organisation's role is to provide or arrange financing, link customer enterprises to know-how and help them build networks for their innovation projects"*.

Finally, in the eyes of some governments, the special commercial and political risks and challenges involved in export activities, which prove a deterrent to some enterprises, justify public authorities stepping in to promote growth and employment through exports. The aforementioned risks may be legal, political or logistical.

- Legal risks are related to the fact that the international legal framework is often complex, sometimes non-existent and constantly changing. Related to this are the hazards associated with international payments, such as risks of non-payment or the need to master payment technologies and methods.
- Political risks, in the form of instability in the client country leading to defaults on payments, the confiscation of assets or the obstruction of exchange transfers, represent hidden transaction costs that may hamper international trade. Some studies argue that such circumstances amply justify government insurance schemes. For instance, Moser *et al.* (2008) show that German public export credit guarantees mitigate the blockage of trade flows stemming from political risks and thus promote exports. They explain that the reason for promoting exports through public credit agencies *"is that the private market is unable to provide adequate insurance for all risks associated with exports. As a consequence, firms' export activities are limited in the absence of insurance provision."* Indeed, they conclude that public-sector guarantees have a significant, positive impact on exports.
- There are also major transport-related risks involved, entailing possibilities of theft, damage or destruction of goods.

[24] See *Is Small Beautiful and Worthy of Subsidy?*, T. BIGGS, World Bank, 2001.

In view of all these hazards associated with the export activity and the direct benefits of export businesses for domestic economic development and job creation, export promotion appears to be one of the most frequent promotional missions.

3.3. General-Interest Missions

3.3.1. Rationale

Financial institutions pursuing general-interest missions focus either on investing in socially valuable, but financially unprofitable, ventures or on compensating for the private sector's short-sightedness by funding investments that yield only a long-term return.

a) Maximising Positive Externalities

One important trait of the private banking system is the limited incentives it has to finance projects associated with large positive externalities. Investment projects that are of great social benefit but are financially unprofitable (since the social benefits cannot be privatised) are less likely to be financed by private lending institutions. As a result, many potential improvements to the welfare system ultimately remain unfulfilled.

By contrast, public banks can realistically consider positive externality projects in their investment choices such as in the environmental, social, cultural or sport domains. These potentially major positive externalities are not reflected in their balance sheets and profits, although they are essential to the respective local and national communities. This attention paid to social benefits in addition to sustainable financial profitability defines the so-called 'dual-bottom line' banks.

Another positive externality arises when public banks provide funds for other services. On the one hand, public banks are the main back-up source of liquidity for all other financial institutions in the economy; on the other, they are one of the main channels for implementing government monetary policy. Indeed, the private banking system has no incentive to lend during economic downturns, which diminishes the effects of an expansionary monetary policy. In this connection, it is vital to have public banks ready to channel funds and thus implement countercyclical financial policies.

b) Compensating the Private Sector's Short-Sightedness

In market economies, market pressure and competition often prevent private companies from investing in long-term projects. They usually cannot afford high

levels of illiquidity on their asset-side balance sheet, simply because, as J.M. Keynes pithily put it, *"in the long run we are all dead"*, the exception being public authorities. This is a very basic, yet crucial, rationale for the establishment of public financial institutions. Typical illiquid and long-term projects include electric utilities (e.g. power stations), energy networks (such as gas or oil pipelines) or even simply roads.

3.3.2. Examples across Europe

Public financial institutions fulfilling general-interest missions cover a wide range of activities, from supporting agriculture to promoting tourism and financing education, infrastructure and/or sustainable development.

a) Agriculture

Insofar as food self-sufficiency is considered a key political goal of European governments, there is clearly a need for some way of channelling funds to a sector that, if left to economic forces alone, would shrink dramatically. Food sovereignty is the main rationale for the existence of the European Union's Common Agricultural Policy (CAP), which sets out to guarantee farmers minimum prices for their output, whilst also subsidising their exports and safeguarding their rural lifestyle. Consequently it is critical to organise public institutions in such a way that they can channel financial support to the farming sector.

- In Poland, Bank Gospodarki Żywnościowej is the leading provider of banking products and services *"facilitating the management of a farm and enabling the efficient functioning of agricultural food-industry companies"*. The products offered consist of credits for various kinds of investments, loans to cover disasters, and leasing services for machines and equipment (cars, pick-up trucks, lorries, and so on).
- In Greece, ATE bank (formerly the Agricultural Bank of Greece), offers savings-related and financing services to farmers, among others.
- The largest Turkish bank is the Agricultural Bank of the Republic of Turkey, which aims to sustainably finance the entire agricultural sector in a bid to sponsor specific projects set up for a product/region, cover every type of investment and operating cost for producing, processing, evaluating, storing and distributing agricultural produce that can be readily marketed domestically and abroad, and fund hi-tech developments and advances in knowledge that boost production[25].

[25] Paraphrased from www.ziraat.com.tr.

Besides the political importance of agriculture the sector is also economically significant in a number of mainly Eastern European countries[26], including Bulgaria (accounting for 8.5% of GDP), Croatia (7.4%), Lithuania (5.3%), Macedonia (13%) and Romania (10.5%). In Romania, for instance, CEC Bank focuses in particular on agricultural SMEs, whilst ATE bank also has a subsidiary there.

Since 1997, when the European Council defined the 'European Model of Agriculture' as a modern, sustainable sector with quality standards and embedded in the rural way of life, one main goal among post-Communist countries in Eastern Europe with the attainment of those targets in mind, has been to reorganise a ruined farming sector characterised by fragmentation, low incomes and a low level of market integration. In this context, *"agricultural development serves as a poverty alleviation strategy"*[27]. Support provided to the farming sector in these countries often takes the form of underwriting collateral for bank loans as well as direct lending.

b) Education

Since education enables a long-term increase in productivity and prepares Europeans for an increasingly knowledge-based economy, it is deemed one of the most important long-term investments for our economies. The universal nature of education and the extent of the associated investment horizon are both arguments invoked in favour of government intervention for promoting education and accordingly for the use of financial institutions to channel the necessary funds.

In practice, education can be promoted in several ways, e.g. by promoting the financing of public school buildings and universities or providing loans for teaching aimed at unemployed adults. Promoting education is thus closely related to job promotion. For example, in the German federal state of Thuringia the *Gesellschaft für Arbeits- und Wirtschaftsförderung* (GFAW), a subsidiary of the publicly owned Thüringer Aufbaubank, implements sophisticated programmes for promoting education, using both internal funds and financing stemming from the European Social Fund (ESF), playing particular emphasis on training for young people. Founded in 1957, the ESF aims to improve people's job prospects by developing their skills, boosting their productivity and promoting training designed to enable them to face new global challenges more effectively. Accordingly, educational institutions routinely apply for funding, and the GFAW then decides whether or not to allocate the respective funds.

[26] These 2006 figures come from EarthTrends.com: http://earthtrends.wri.org/searchable_db/index.php?action=select_countries&theme=5&variable_ID=214.

[27] See "The Role of Agriculture in Central and Eastern European Rural Development: an Overview", M. PETRICK, P. WEINGARTEN in *Studies on the Agricultural and Food Sector in Central and Eastern Europe*, 2004.

c) Infrastructure

Infrastructure is traditionally recognised as the prerogative of governments owing to the high capital expenditure involved, the long-term effects and potentially massive impact on development. One typical example of a public bank strongly geared towards financing public infrastructure development is the Dutch entity Nederlandse Waterschapsbank, which, among other things, finances hydraulic projects across the country, meeting an obvious national need.

There is an abundance of other examples of public financial institutions strongly committed to financing infrastructure projects. For instance, the Czech-Moravian Guarantee and Development Bank (CMZRB) provides Czech municipalities with long-term loans to help them fund *"specific projects focussed on improving the infrastructure of towns and municipalities, particularly their water supply and waste water treatment"*. Similarly, the website of the Investment Bank of Schleswig-Holstein (IBS-H) claims that it supplies solutions for *"public infrastructure financing as well as for city development, environmental and energy projects"*.

The overall rationale for public financing of infrastructure is, as L-Bank, the state bank of Baden-Württemberg, argues, that *"people and companies prefer to settle in communities with a suitable infrastructure – in other words, where modern public facilities and public transport exist"*.

Yet local public authorities, on a stand-alone basis, would mostly be excluded from market financing because of their small size. In some countries, municipalities are thus naturally led to join together and centralize the fund raising, particularly if it is to take place on the international market. Prominent examples of this strategy can be found in the various Nordic countries, for example one can name Municipality Finance in Finland.

d) Tourism

The fact that Europe is the world's leading tourist destination makes tourism "*an economic activity capable of generating growth and employment in the EU, while contributing to the development and economic and social integration, particularly of rural and mountain areas, coastal regions and islands, outlying and outermost regions or those undergoing convergence*". The European tourism industry numbers some 1.8 million businesses, mainly SMEs, representing nearly 10 million jobs and generating over 5% of the EU's GDP. *"Taking into account the sectors linked to it, tourism's contribution to GDP is even greater; it is estimated to generate over 10% of the European Union's GDP and provide approximately 12% of all jobs"*[28]. Besides this economic clout, tourism is also

[28] See *Europe, the world's No. 1 tourist destination – a new political framework for tourism in Europe*, Communication from the European Commission, 30 June 2010, Brussels.

an important way for Europe to project its image and social model throughout the world.

Tourism's significance for Europe has been recognised in the Lisbon Treaty, which sets out a series of systems designed to shore up the European Union's capability to support, coordinate and complement actions taken by the Member States and thereby lay the foundations for a European tourism policy. In particular, Article 195 of the Treaty on the Functioning of the EU stipulates that the European Union can *"promote the competitiveness of undertakings in this sector and create an environment conducive to their development"*. These advances are likely to necessitate the strengthening of financial institutions collaborating with key players from the tourism industry.

The most representative example of such an institution is the Austrian Bank for Tourism Development (ÖHT), which not only offers low-interest loans to SMEs active in the tourism and leisure industry all around Austria, but also conducts consultations, particularly on business planning, as well as providing training on the restructuring and financing of tourism businesses. In 2009, some 1,500 projects received support totalling around € 32 million and 186 tourism entrepreneurs received financial assistance to launch an activity. Moreover, in 2010, in keeping with the emphasis placed on the importance of the tourism industry for Europe, the European Investment Bank, which functions as the EU's bank, granted ÖHT a € 110 million loan *"to finance SMEs active in the Austrian tourism industry"*.

e) Environmental Sustainability

Environmental sustainability is an essential goal for the governments of many countries, particularly advanced economies, which set ambitious targets for internalising or curbing economic externalities that pose a threat to the environment (e.g. cutting greenhouse gas emissions), improving energy efficiency and increasing the proportion of energy derived from renewable resources.

Yet all too often the systems and technologies needed to reach these targets are either uneconomical or subject to network effects that require state intervention. For instance, public financial institutions invest in relevant R&D and fund companies that generate renewable energy (e.g. via wind turbines, solar installations, and the promotion of biofuels) or any innovative project capable of enhancing the environment. Moreover, various housing banks finance building renovation designed to ensure compliance with tougher energy efficiency norms (one example being Husbanken in Norway).

In Poland, Bank Ochrony Środowinska (BOS) is an excellent example of a bank that offers a wide range of credit facilities for financing investments in environ-

mental protection. In particular, it offers 'pro-ecological preferential credits' from earmarked (national or European) ecological funds for the conservation of water, air and land surfaces, as well as credits for waste collection and processing businesses.

The Nordic Investment Bank (NIB), the international financial institution serving the Nordic countries (Denmark, Finland, Iceland, Norway and Sweden), is another example of a public financial institution intent on promoting sustainable development. The NIB's mission statement declares that it *"promotes sustainable growth of its member countries by providing long-term complementary financing, based on sound banking principles, to projects that strengthen competitiveness and enhance the environment"*. Before making any lending decisions, the NIB analyses the direct and indirect environmental impact of the projects it is being asked to co-finance.

3.4. Geographically Focussed Missions

3.4.1. Rationale

As noted in the previous chapter, many public financial institutions were expressly set up to serve a given territorial area. The main rationales for this are to be found in the risk of capital drain and in the need to foster private savings by the general population.

a) Preventing Capital Drain from Poorer to Richer Regions

In a richer region, entrepreneurs can promise to pay higher interest rates than in a poorer region. If both regions display symptoms of credit rationing, private financial intermediaries will maximise profits by diverting capital away from poorer to richer regions. This capital drain can be countered by establishing a public bank bound by a territoriality principle.

b) Jump-Starting Financial Development to Avoid Disintermediation

Public banks can play an important role in the economic and financial development of nations. In developing countries, some private banks might behave opportunistically, e.g. by not honouring their contracts with depositors when the probability of legal contract enforcement is low. When institutions are underdeveloped, depositors will tend to shun private banks for fear of such opportunistic behaviour and instead favour safer, state-run banks. Public banks can thus help by keeping private banks honest and by providing the level of confidence in the financial system that is essential for avoiding disintermediation and jump-start financial and economic development.

The development of financial markets by public banks itself helps to foster economic development, thus starting a virtuous circle of economic and financial welfare creation. From the national viewpoint, this may not be deemed relevant nowadays, but at the local level it can remain quite relevant. Indeed, the development of local economies is one of the main rationales for public banks. The presence of trustworthy local public banks fosters the accumulation of savings by the general public. This intermediary role played by public banks in unsophisticated financial markets is important, since it allows for economic agents in financial surplus (depositors) to allocate funds efficiently to economic agents in financial deficit (borrowers). This fundamental role of public savings banks paves the way for a much closer relationship between the bank and its customers, further reducing informational asymmetry, which remains characteristic in arms-length relationships.

Financial inclusion is another of the main rationales for the existence of public banks. As pointed out above, the provision of financial services for both depositors and borrowers in rural and isolated areas gives rise to tremendous benefits in terms of economic development, employment and poverty reduction, but often proves financially unprofitable. The same situation arises with respect to the provision of basic financial services for the underprivileged. More fundamentally, the provision of financial services to all citizens, regardless of their geographical location, is often considered an essential, fundamental right.

3.4.2. Examples across Europe

Historically, local banks, known as ‘savings banks’, were set up by local government authorities to deploy their assets in awarding loans designed to benefit their local economy, thereby de facto acting as retail banks from the outset, albeit with various restrictions imposed on their lending practices. Although established by government authorities, they were deliberately autonomously managed. Subsequently, similar institutions flourished at various territorial levels, but always with the emphasis on being a financial institution serving a certain area, which is why we use the term ‘geographically focussed public banks’ to describe them.

Today, the main products and services offered by geographically focussed public banks (mainly municipal credit banks, cantonal banks, Austrian ‘Hypo banks’, *Landesbanken* and *Sparkassen*) still mostly revolve around *retail banking*.

In terms of stakeholders, geographically defined public banks view ‘other banks’ as relatively important stakeholders. By contrast, interestingly, although close to 30% banks subject to strong public influence consider SMEs to be important

stakeholders, SMEs do not seem to be privileged target stakeholders. What is more, public companies tend to 'under-focus' on their employees and show less concern for their shareholders. Typically, their customers have always included persons and institutions with few financial assets, thus compelling them to keep risks to a minimum.

Geographically focussed missions have two main characteristics:

a) Universal Service

The provision of banking services to the underprivileged has always been key to ensuring the integration of such people into everyday life. Ensuring that everybody has a bank account is essential in today's modern economies, where most financial transactions are effected via intermediaries, using a complex infrastructure. In that respect, it is an important duty of public authorities to provide some basic financial services in places where commercial institutions do not find the necessary economies of scale and to people whom commercial institutions view as unprofitable. Since banking services are to be regarded as a universal service, similar to postal services, public authorities must aim to ensure that there is a sufficient number of bank branches within their respective territory. This is usually the case where post office banks, cantonal banks or regional and savings banks are concerned.

b) Financial Inclusion

Financial inclusion emerges as the overriding objective of geographically focussed public banks, which value proximity with the client and relationship-based banking (many define the general public as their customer base). Furthermore, only some of these public banks offer a pawnshop service, which clearly is a financial inclusion tool in so far as pawnshops are institutions designed primarily to help the poor and underprivileged. Often constituting a 'last-resort' service, pawnshops are a very old form of banking service.

3.5. Financial Institutions Pursuing a more General Mission

Financial institutions in this cluster are not characterized by precise objectives and their missions target a rather wide audience, with products and services relatively diverse. Moreover, among them, we find many financial institutions with public participation having a greater tendency to follow the path of internationalisation.

In keeping with this, regarding the names of these companies, we find more frequent instances of terms like 'Bank' or 'Group' and encounter numerous subsid-

iaries of sizeable groups, like DnB NOR or BNP Paribas[29]. Usually, the names of these entities resemble brands, comprising proper nouns, like Nordea, Vipa or Clientis. The sole objective of financial institutions with only minor public participation also appears to be the broadest possible, namely 'economic development', a fact that appears to confirm that financial institutions with only a small public shareholding are those with the greatest proclivity for involvement in general activities. Furthermore, shareholders emerge as these institutions' most important stakeholders alongside their employees.

We can identify two main types of banking institutions with non-controlling public-sector involvement:

a) Strategic Ownership

In a number of cases, governments deliberately hold on to a significant yet non-controlling stake in such financial institutions so that the respective public authorities can retain some strategic influence, or a blocking minority, to safeguard national interests. DnB NOR in Norway is a case in point. A report published in 2008 by the Norwegian Ministry of Trade and Industry on the government's ownership policy states that *"the purpose of the state's ownership interest in DnB NOR ASA is to ensure that the group has its head office in Norway and that the company acts as a partner for Norwegian companies in Norway and in the export market. This provides business and industry with access to a large and highly competent Norway-based financial group."*

b) Domestic Ownership with International Scope

We also find banks that are characterised by domestic ownership but subsequently expanded internationally. It would seem that public authorities either just 'happen' to hold stakes in these institutions or have maintained their interest as the bank progressively evolved and moved further away from being a strictly public company.

For example, in the late 1990s the Swedish bank Nordea started to expand into a truly international group through various mergers and acquisitions, covering all Nordic countries first and later the Baltic countries and Poland. Today it has more employees in Finland and Denmark than in Sweden and considers itself a *"universal bank with leading positions within corporate merchant banking as*

[29] However, it is important to bear in mind that BNP Paribas, a leading global bank, appears here exclusively due to the Belgian government's stake, held via the Federal Holding and Investment Corporation (FHIC), in BNP Paribas' capital, following the bail-out of the Belgian bank Fortis, subsequently acquired by BNP Paribas. As such, the significance of this shareholding in the framework of the present study should not be overrated.

well as retail banking and private banking. It is also the leading supplier of life and pensions products in the Nordic countries"[30].

In Slovenia, the Nova Ljubljanska Banka (NLB) Group was established in 1994 by a legislative act of the country's National Assembly to assume the assets and liabilities of Ljubljanska Banka. NLB went on to make various acquisitions and forge a number of strategic partnerships. Then in 2001, the government launched its privatisation programme for NLB, which entailed the bank continuing to increase its domestic market share and later expanding its activities into South-East Europe, in the process becoming the largest banking group in Slovenia and offering a tremendous variety of products and services (ranging from lease financing to commercial banking, asset management, private banking and corporate finance).

3.6. Conclusion

The missions of partly publicly owned financial institutions are arrayed in four major categories: promotional missions, general-interest missions, geographically focussed missions and general mission, the latter being mainly constituted of financial institutions with a public participation.

Public financial institutions fulfil a huge range of specific missions. Among these, banks with a promotional mission stand out by primarily addressing market insufficiencies, such as the SME-financing gap, covering the hidden transaction costs of exports and fostering innovation, whereas other financial institutions are more likely to address general-interest missions, from supporting the agricultural sector to developing infrastructure and promoting tourism. These missions all respond to market needs which, for various reasons – ranging from the extent of the investment horizon to the presence of external factors – are underserved by the private banking sector.

In addition, promotional and general interest focussed public financial institutions also appear to complement geographically oriented public banks remarkably well. Indeed, while the former concentrate on mitigating market insufficiencies, public banks that are primarily focussed on their regional geographic scope primarily strive to financially include everyone, and therefore end up providing mostly retail banking services and pursuing schemes deemed to be in the general interest.

Finally, financial institutions with a public participation tend to be more internationally oriented and appear less focussed on narrower objectives. Investment banking and asset management – services that are infrequently on offer from pub-

[30] See Nordea's 2009 annual report.

lic companies – are more frequently provided by institutions falling into this category and, significantly, shareholders emerge as their most important stakeholders alongside these banks' actual employees.

This tremendous variety and diversity in the missions assumed by public financial institutions can be explained by structural market characteristics calling for public intervention.

Table 5 – Overview of the missions of financial institutions with public participation

Category	Code	Promotional missions	General interest missions	Geographically focused missions	General missions
Objectives	Job Creation	20%	10%	3%	3%
	Economic Development	91%	64%	70%	34%
	Financial Inclusion	5%	5%	21%	3%
	Environmental Sustainability	11%	22%	6%	3%
	Agriculture	5%	17%	3%	6%
	Tourism Industry	5%	2%	1%	3%
	Education	5%	8%	1%	3%
	Infrastructure	14%	31%	4%	0%
	Energy	9%	7%	2%	0%
	Sport and Culture	0%	5%	7%	0%
	Pawnshop	0%	0%	21%	0%
	Export	32%	5%	2%	0%
	Innovation	32%	12%	4%	0%
Geography	Regional	50%	31%	88%	13%
	National	57%	76%	18%	59%
	International	11%	14%	11%	41%
Stakeholders	General Public as Customers	7%	27%	89%	88%
	General Public as Stakeholders	16%	10%	11%	9%
	Shareholders	7%	7%	6%	25%
	SMEs	75%	44%	46%	41%
	Public Entities	36%	56%	17%	22%
	Other Banks	16%	24%	13%	13%
	Employees	5%	5%	12%	16%
Activities	Retail Banking	7%	25%	85%	88%
	Commercial Banking	77%	63%	73%	84%
	Wholesale Banking	70%	54%	65%	84%
	Mortgage Banking	14%	46%	58%	38%
	Asset Management	11%	8%	9%	34%
	Investment Banking	66%	19%	32%	44%
	Public Banking	18%	47%	16%	19%
	Consulting	34%	31%	5%	13%
	Guarantees/Insurance	23%	20%	25%	28%
	Settlement	0%	3%	5%	3%
	Subsidies	32%	19%	1%	0%
TOTAL (Number of institutions)		**68**	**74**	**114**	**34**

NB: In each segment, the percentages do not add up to 100% because one institution can take several of the codes
Source: Elaborated by the Authors.

4. PUBLIC FINANCIAL INSTITUTIONS' BUSINESS MODELS

There is a need to refine and further specify the general notion of 'public banks' by providing an archetypal typology of public financial institutions' business models. The different rationales and the variety of missions underpinning the creation of public financial institutions has led to the emergence of different business models by which public financial institutions operate: special credit institutions (including national and regional development banks and agencies, export credit agencies and municipal credit institutions), public savings banks, long-term investors and public financial intermediaries.

It is important to note that it would be virtually impossible to provide an exhaustive overview of all the existing business models for public financial institutions in Europe. Therefore, we identify and present a set of key business models that are not meant to describe particular financial institutions (in particular, a given financial institution can pertain to more than one of business models presented hereunder). Rather, they show how particular rationales for public intervention to a great extent influence and determine the typical characteristics of the resulting business models.

4.1. Special Credit Institutions

In accordance with the 2002 EU-Germany Understanding[31], Special Credit Institutions in the EU are allowed to be active in the following restrictive list of areas:

- fulfilment of public promotional activities e.g. financing SMEs, risk capital, environment-friendly investment, technology, innovation, infrastructure, housing as well as internationally agreed promotional programmes (e.g. CIRR, LASU, etc.) and co-operation with developing countries;
- participation in projects in the interest of the Community, which are co-financed by the European Investment Bank or similar European financing institutions;
- granting of loans and other forms of financing to the Federal State, Länder, municipalities and special purpose associations of public legal form (öffentlich-rechtliche Zweckverbände);
- measures with a purely social character, e.g. social housing, financing of social institutions, financing fulfilling the conditions laid down in provisions of social law (regarding educational situation, unemployment, low income or wealth, handicaps, etc.);
- export financing outside the European Union, the European Economic Area and countries with the official status of a candidate for accession to the

[31] See European Commission, *Understanding about the orientation of legally independent special credit institutions in Germany*, 1st March 2002.

European Union, as far as this is in compliance with international trade agreements, which bind the Community, in particular the WTO agreements.

Special credit institutions may also engage in services and other financial activities, such as treasury management, risk management and consultancy on their promotional activities, as long as they are directly in connection with the fulfilment of their promotional tasks and serve that purpose.

We identify three key business models pertaining to the above restrictive list of allowed activities for Special Credit Institutions, namely (1) National and Regional Development Banks and Agencies (NRDBAs), (2) Municipal Credit Institutions (MCIs), and (3) Export Credit Agencies (ECAs).

4.1.1. National and Regional Development Banks and Agencies (NRDBAs)

Also known as 'promotional banks', NRDBAs constitute a financial institution category that has been recognised as such by the EU-Germany Understanding. Promotional banks are special credit institutions set up by public authorities either at a regional or national level to implement investment projects in the local economy aimed at fostering economic and social development, for example by investing in infrastructure or providing support for SMEs. Their public mission is usually stipulated in a short special law indicating the purpose and ways of operations of the institution. To avoid any conflict between European State aid rules, the scope of activity of these entities has to be in direct connection to their assigned tasks. Moreover, in fulfilling their mission, NRDBAs should strive to correct the market insufficiencies and be complementary to private banks rather than competing with them.

a) Financing

Like all other public financial institutions, NRDBAs are endowed by the public authorities with a certain amount of equity capital when they are founded. Most development agencies resort to market financing while only a minority is solely funded through public equity endowments. In Belgium, an example of the latter is the Regional Investment Company of Wallonia (SRIW), which has a € 745 million investment portfolio that is wholly financed through equity capital and retained earnings.

Yet most NRDBAs take advantage of their explicit or implicit state guarantee to resort to market financing, mostly by issuing bonds and benefiting from attractive rates. For instance, in Germany, at the regional (state) level, development banks act on behalf of their regional authorities and support the respective state (Bundesland) in fulfilling its structural tasks. Each region has its own development

bank e.g. Thüringer Aufbaubank, NRW.Bank for Northrhine-Wesphalia, Wirtschafts-und Infrastrukturbank Hessen.

Development banks operate, from the competitiveness point of view, in a neutral and non-discriminatory manner, i.e. their services are provided to everybody on equal terms. Furthermore, the benefits gained from the guarantor liability provided by the individual state authorities and preferential terms of refinancing achieved are supposed to be reinvested in the promotional funding cycle.

There also exist various EU sources of funds for NRDBAs. Indeed, European Structural Funds have gradually grown in importance as a financing tool for NRDBAs. At present, the EU is endowed with 3 major structural funds: the European Regional Development Fund (ERDF), the European Social Fund (ESF), and the European Agricultural Fund for Rural Development (EAFRD). These structural funds aim to fulfil 3 objectives, respectively: 1) foster the economic development and structural adjustment of regions that are lagging behind; 2) ensure the economic and social conversion of areas facing structural difficulties; 3) finance the rural development programmes of the Member States.

The European Commission requires partial co-funding by national authorities for projects supported by structural funds and proper management, monitoring and evaluation of the funds' use. For these reasons, NRDBAs' expertise and operational independence from governments have put them at the heart of the EU's development policies. When a regional or national project is being funded jointly out of the EU's structural funds and by national or regional authorities, NRDBAs coordinate, manage and monitor the respective project's expenditure and progress and then report back to both the national or regional officials and the European Commission.

b) Activities

The promotional areas privileged by NRDBAs encompass *"SME financing, risk capital, environment-friendly investment, technology, innovation, infrastructure, housing as well as internationally agreed promotional programs and co-operation with developing countries"*[32].

NRDBAs can adopt a direct or an indirect lending scheme, the former requiring decentralized operations through regional offices. Nordic countries are strong proponents of this first strategy. Oseo in France is another striking example of the direct lending model. An indirect lending strategy, in contrast, leads to greater centralization of operations and delegation of project selection and risk assess-

[32] See European Commission, *Understanding about the orientation of legally independent special credit institutions in Germany*, 1st March 2002.

ment to other banks. In this case, NRDBAs often act as a refinancing tool for more local banks ('house banks' or 'principal bank').

The indirect lending model is traditionally more present in Spain or Germany (there, referred to as the 'Hausbankenprinzip'). This model relies on that an enterprise deals with a preferred bank chosen by itself whatever the type of bank (saving bank, private bank, co-operative bank, etc.). The enterprise transacts the main share of its business to a principal bank where the current account is maintained and the business relationship is supposed to be long-lasting. When the enterprise needs promotional loans and financial aid, it applies to the principal bank. The development bank then stipulates the terms and conditions of the funding loan. The principal bank has no possibility of controlling or changing the terms and conditions of the promotional loan although it may ensure the complete financing of the project and produces sources and disposition statements for the contract which are necessary for the project.

This system of financing allows for an improvement of financing terms. Moreover, although the principal bank acting as intermediary usually takes on much of the credit risk, risk sharing is also encountered. On its side, the development bank has neither an influence on an enterprise's choice of principal bank nor on the total volume of promotional loans. Hence, the principal bank procedure as a distribution channel for the promotional financing of companies meets the required competition neutrality and non-discriminatory nature of development banks. Of course, this system does not preclude resorting sometimes to direct financing, for example in the case of entrepreneurial loans.

More generally, to fulfil their mission of fostering economic and social development, NRDBAs must be capable of adapting their products and services to the particular requirements of individual projects. For this reason, NRDBAs propose a wide variety of products and services tailored to the individual needs of their customers. Besides traditional commercial loans and guarantees to support SMEs and innovative firms, they also act as business angels by providing seed and venture capital to entrepreneurs and innovative SMEs. Some NRDBAs even undertake management buyouts and cooperate to establish joint ventures to support SMEs throughout their development.

4.1.2. Municipal Credit Institutions (MCIs)

MCIs are banks or funding agencies that specialise in providing financial services to municipalities. Through their activities, they aim to reduce the cost of capital for local governments. For example, Kommuninvest of Sweden estimates that it has helped to reduce the municipal sector's financing costs by € 32.2 million. The following sections will shed some light on the various organisational struc-

tures of MCIs, on their sources of financing and on the products and services they offer.

a) Organisational Structures

MCIs can have very different organisational structures, namely being established either as customer-oriented firms, or as member-owned credit cooperatives. When founded as customer-oriented firms, their share capital is commonly owned by either the central government or the municipalities or jointly by both. Using their equity capital and debt instruments issued on financial markets, they provide financial services for municipalities within a certain geographical area (i.e. a country). Examples of this customer-oriented setting are provided by Kommunalkredit Austria (99.8% owned by the Austrian State and 0.2% by the Association of Austrian Municipalities (ÖGB)) and Kommunalbanken Norge, which is wholly owned by the Norwegian state.

The second organisational structure under which MCIs are often set up is a member-owned credit cooperative, where MCIs provide their members (i.e. municipalities) with financial services that are partly funded by members' original equity capital, but mainly through market financing. The members of municipal credit cooperatives are then jointly liable for their MCI's financial obligations. Examples of such cooperatives are Kommuninvest in Sweden, and Kommunekredit in Denmark.

A third structure can be found in Bank Nederlandse Gemeenten (BNG) that is a statutory two-tier company under Dutch law. Half of the bank's share capital is held by the State of the Netherlands and the other half by municipal authorities, provincial authorities and a water board.

b) Financing

Most municipalities face the problem that, although their investment projects might be profitable, their small size denies them access to market financing at attractive rates. Therefore, by pooling their resources within a single entity (a MCI), municipalities can combine to attain the 'critical mass' required to bring attractive market financing within reach. The attractiveness of municipality finance for investors is further enhanced by some form of state guarantee on the financial obligations of MCIs. Most of the time, the state guarantee is implicit; in the case of customer-oriented institutions, the liability is limited and borne by the shareholders (who often include the state), and in the case of cooperatives it is borne by its members, and is then usually unlimited. The assumption that the financial activities of MCIs benefit from state guarantees and/or supports are clear from the financial ratings enjoyed by of these institutions, which mostly mirror their country's rating.

Table 6 – Financial ratings of MCIs Institution Financial rating (S&P)

Institution	Financial rating (S&P)
Kommunekredit (Denmark)	AAA
Kommunalbanken (Norway)	AAA
BNG (Netherlands)	AAA
Kommuninvest (Sweden)	AAA
Kommunalkredit (Austria)	A
Municipality Finance (Finland)	AAA

Source: S&P 2009

c) Activities

Various types of financing have been developed over the years, all tailored to the specific needs of municipalities and local quasi-public institutions (such as housing institutions, educational establishments, healthcare institutions, and so on). Since most local authorities are under a legal obligation to balance their budgets, debt financing is paramount for local governments. So it is hardly surprising that debt financing is the primary financial service that MCIs offer to municipalities.

Consequently, most MCIs also offer project finance loans for local infrastructure projects or loans guaranteed by sector-specific state guarantee funds (such as the Waarborgfonds Sociale Woningbouw (WSW) for social housing and the Waarborgfonds voor de Zorgsector (WFZ) for the healthcare sector in the Netherlands). Some MCIs even provide financing for public-private partnerships or venture capital for riskier public projects.

4.1.3. Export Credit Agencies (ECAs)

Export Credit Agencies' main mission is to help finance exports of national goods and services to international markets. As such, they aim to boost domestic exporters' competitiveness in global markets.

a) Legal Framework

Since export credits and guarantees can potentially distort competition in international trade, they are subject to the Agreement on Subsidies and Countervailing Measures (SCM Agreement) adopted by the World Trade Organisation (WTO). Specifically, Annex 1 of the SCM Agreement provides an 'Illustrative List of Export Subsidies' prohibited by the WTO. Among other things, Annex 1 prohibits:

1 *The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes, of insurance or*

guarantee programmes against increases in the cost of exported products or of exchange risk programmes, at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes.

2 *The grant by governments (or special institutions controlled by and/or acting under the authority of governments) of export credits at rates below those which they actually have to pay for the funds so employed (or would have to pay if they borrowed on international capital markets in order to obtain funds of the same maturity and other credit terms and denominated in the same currency as the export credit), or the payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credits, in so far as they are used to secure a material advantage in the field of export credit terms.*

However, the second paragraph of point 2 provides for an exception for WTO member countries applying the provisions of the OECD's Arrangement on Guidelines for Officially Supported Export Credits, stating that they *"shall not be considered an export subsidy prohibited by this Agreement"*.

The OECD's Arrangement on Guidelines for Officially Supported Export Credits, which is currently ratified by Australia, Canada, the European Union, Japan, Korea, New Zealand, Norway, Switzerland and the United States, first entered into force in April 1978. However, it is a 'gentlemen's agreement' and does not carry the legal force of an official OECD act. Its stated purpose is to *"provide a framework for the orderly use of officially supported export credits" and to "foster a level playing field for official support [...] in order to encourage competition among exporters based on quality and price of goods and services exported rather than on the most favourable officially supported financial terms and conditions"*.

Amongst other things, the aforementioned Arrangement covers the financial terms and conditions for export credits. The OECD also provides a list of official ECAs complying with the Arrangement.

For the EU Member States, Article 132 of the Treaty Establishing the European Community stipulates that *"Member States shall progressively harmonise the systems whereby they grant aid for exports to third countries, to the extent necessary to ensure that competition between undertakings of the Community is not distorted. On a proposal from the Commission, the Council shall, acting by a qualified majority, issue any directives needed for this purpose."* To this end, Council Directive 98/29/EC sets out provisions for the harmonisation of export credit insurance with medium and long-term cover.

b) Activities

ECAs cover both commercial and political non-payment risks for exports. The commercial risks at issue here include debtor insolvency and unwillingness to pay. The political risks include the confiscation of goods, restrictions within the international payment system, payment moratoria, the non-convertibility or non-tradability of foreign funds, legislative or administrative measures taken by public authorities against exporting firms, and war or similar hostilities.

Furthermore, ECAs provide export pre-financing loans designed to finance the expansion of production needed to fulfil export orders or provide guarantees for banking loans to export companies. To facilitate the conclusion of export contracts, ECAs also provide buyer's credits to foreign customers of exporting firms, whereas some additionally offer insurance services that cover foreign investments by domestic companies. What is more, some ECAs provide extensive studies of country-specific risks so that potential exporters can assess the risks associated with exporting to particular countries. For example, Hungary's Eximbank has a total loan portfolio of € 580 million and total guarantees totalling over € 150 million.

4.2. Public Savings Banks

Public savings banks are banks whose operations are primarily defined through the geographical scope of their activities. They have strong ties to a particular region and primarily deliver financial services within that geographic area. Most institutions of this kind are retail banks, of the type found in numerous countries (crédits municipaux in France, cajas de ahorros in Spain, Landesbanken and Sparkassen in Germany, cantonal banks in Switzerland, Regionalbanken ('Hypo') in Austria, etc.). Yet whereas these public banks are all savings banks, not all savings banks are public banks.

a) Savings banks vs. Public savings banks

Savings banks can be generically defined as regional banking institutions, primarily involved in retail banking. Savings banks have historically developed around two rather different business models, involving different institutional forms: cooperatives or foundations. Cooperative banks are member-owned organisations which belong to local citizens in a given area and are therefore private institutions. For this reason, they are de facto excluded from the scope of the present study.

The defining peculiarity of foundations is that, strictly speaking, they do not have any 'owners'. Rather, they are self-owned financial institutions which grow pri-

marily through retained earnings. Yet despite this lack of owners, the operations of foundations are controlled by a Board of Trustees, the exact composition of which is defined in the respective bylaws. This means that savings banks set up as foundations can be either public or private, depending on the exact composition of their Board. The control criterion adopted in the present study allows us to distinguish between these two types of 'ownerless' foundation.

At the same time, it is important to note that as corporate law evolved throughout the 19th and 20th centuries, some savings banks abandoned either of the aforementioned forms, opting instead to become fully-fledged joint stock companies.

b) Postal Savings Banks

Postal savings banks (sometimes called post office savings banks) were set up throughout the 19th century to offer retail banking services to the masses, building on the success of local savings banks and extensive networks of post offices. The fact that postal savings banks draw both on the philosophy underlying savings banks and the ethos of post offices, makes them, in the words of France's Banque Postale, animated by the dual values of proximity and service to the masses.

Historically, proximity has been achieved by making all retail banking services available in existing post offices. This drastically lowered the cost and sped up the development of postal savings banks, superposed on the existing network of post offices. That approach, which was extremely successful throughout the 19th and 20th centuries, is at risk today as a result of the disappearance of post offices, linked to declining volumes of mail.

Serving the masses, even underprivileged customers, has always been a key aspect of the activities of savings banks. Financial inclusion has now generally become a fundamental public policy objective, supported by public savings banks, both geographically (providing access to financial services in remote areas) and socially (providing basic banking services to all, regardless of their financial attractiveness).

c) Activities

As pointed out above, public savings banks mainly provide retail financial services, essentially bank accounts and general payment services (debit cards, credit cards) for use by their customers and the general public. Yet as their name indicates they also offer savings accounts, often covered by some kind of state guarantee protecting individual savings, and other mainstream savings instruments for retail consumers.

They also use the funds deposited with them as savings to offer loans to their retail customers, both for consumption and investment purposes, such as purchases of durables (like cars and appliances) or housing. In addition, they also provide loans to foster the activities of local SMEs and entrepreneurs.

Finally, alongside their banking activities, they offer the commonest insurance products, such as car and home insurance, life insurance, and so forth.

4.3. Long-Term Investors (LTIs)

LTIs' main mission is to fund profitable or general-interest projects that other financial institutions are either unwilling or incapable of financing. In so doing, they contribute to the economic and social development of the country or region where those projects are implemented. The Long-Term Investors' Club (LTIC) defines long-term investments as *"an investment that has a long-term horizon and that may contribute to sustainable growth, employment and financial stability. [In particular, this refers to] investment in large-scale projects which can express their return potential only over several years, such as knowledge and labour-intensive general interest, low-carbon or infrastructure projects. [It also refers to] an investment that generates stable cash flows in the long run, and thereby, a financially sustainable long-term risk-adjusted rate of return. [Finally, it may refer to] an investment that contributes to financial markets' stability"*[33].

a) Financing

Long-term investors have three main sources of financing: regulated savings, equity stakes held by the state, and market financing (mostly via bonds).

1) Regulated Savings

France's Caisse des Dépôts et Consignations (CDC) and Italy's Cassa Depositi e Prestiti (CDP) are both in charge of 'managing regulated savings and channeling them safely to the financing of public-interest initiatives'[34]. 'Regulated savings' are a particular set of financial savings instruments that are guaranteed by the state, which also sets their interest rates. France has numerous such regulated savings instruments (including the Livret B, Livret Bleu, LDD and Livret Jeune and so on), but the most famous and most widespread one is definitely the Livret A, which comprises more than 75% of all French household savings. In Italy, the CDP's main sources of financing are postal savings products, distributed by the Italian Post Office, Poste Italiane. These savings products are particularly attrac-

[33] Based on Annex 2 of the LTIC's Workgroup Conclusions on banking supervision.
[34] See Profile of the Caisse des Dépôts et Consignations (see www.caissedesdepots.fr).

tive to retail consumers for two reasons: firstly because they are guaranteed by the state, and secondly because their proceeds are exempt from tax.

2) State-Owned Equity Stakes and Market Financing

When set up, LTIs are endowed with initial equity capital by the respective government. However, all LTIs have a separate legal personality from the state that established them, thereby guaranteeing the necessary investment independence from political interference. Yet the share capital only represents between 4.5% and 14.46% of total financing of the overall financing needs of LTIs. Nonetheless, LTIs are in no way dependent on government expenditure or tax proceeds for their financing.

Like all institutional investors, LTIs depend on market financing, and more specifically on bond issues, for their financial needs. Unlike regulatory savings, bonds issued by LTIs are not guaranteed by the state, but because of the strong involvement both of LTIs in national economies and of national governments in LTIs, bonds issued by the latter often enjoy the same financial ratings as assigned to their home country (and thus financing conditions on financial markets). This greatly reduces the cost of capital for LTIs.

b) Activities

LTIs' main activity is investing in long-term projects that are beyond the capability and/or willingness of market operators. A first key type of project falling under this category involves investments in infrastructure. Infrastructure projects supported by LTIs range from transport networks (railways, highways, seaports, airports, and so forth) to energy networks (power grids, gas and oil pipelines, and so on) and generation (power plants, renewable energy, etc.). Sometimes, rather than directly investing in such infrastructure projects, LTIs set up specific funds to finance them. One example of such a fund is the Italian Fondi Italiani per le Infrastrutture (F2i), set up by the CDP. In Poland, BGK finances long-term projects in infrastructure (such as railways, highways, roads, airports, gas) and acts as financing manager and bond issuing agent of the National Road Fund (Krajowy Fundusz Drogowy), thereby financing the construction and modernisation of all highway and road infrastructure in Poland.

Another type of long-term commitment by LTIs are investments in rent and price-controlled social housing and educational infrastructure. Through its offshoot Société Nationale Immobilière (SNI), France's CDC manages over 300,000 units of social housing and builds 90,000 new units every year. Similarly, the German banking group KfW Bankengruppe has a retail bank subsidiary (KfW Privatkundenbank) that promotes the construction of new homes and the moderni-

sation of existing housing. Between 1990 and 1997, KfW helped to modernise over 3.2 million homes in the former German Democratic Republic (DDR).

In addition to their long-term investment horizon, the aforementioned projects are all strongly in the public interest. Other areas of intervention for LTIs that are characterised by a strong degree of public interest are support for SMEs and companies of strategic importance, efforts to protect the environment and promote sustainable development, and the funding of public bodies. For instance, in 2005, the CDC set up Oséo to provide risk capital and loans to start-ups, VSEs and SMEs. Similarly, the KfW banking group's KfW Mittelstandsbank promotes SMEs, business founders and start-ups and has already invested over € 23.8 billion in businesses.

In addition to developing nascent and small businesses, governments have also aimed, with help from LTIs, to develop strategic industries and companies. For example, the CDP in Italy created its Fondo Rotativo per Infrastrutture Strategiche (FRIS) and France's CDC helped to set up the Fonds Stratégique d'Investissement (FSI) which has invested over € 1.4 billion in strategic businesses and sectors.

One last area of activity for LTIs is the financing of public entities, where LTIs help local communities to finance infrastructure and mortgage projects. For example, the CDC has invested over € 425 billion in regional development in France. Some LTIs also operate as public sector financial institutions, offering banking services to ministries, government departments, social security organisations and such like. In France the CDC is even in charge of managing the country's public and semi-public pension systems.

c) International Cooperation of LTIs

In 2009, Europe's main LTIs (the EIB, CDC, CDP and KfW) set up the Long-Term Investors' Club (LTIC) to coordinate their activities in the global economy in support of sustainable economic growth.

Previously, in 2009, together with the ICO and PKO Bank Polski, the future LTIC's members founded the 2020 Euro Fund for Energy, Climate Change and Infrastructure, dubbed the 'Marguerite Fund'. This fund totals € 1.5 billion and its objectives are to invest in the development of Trans-European Networks in Transport and Energy (TEN-T and TEN-E respectively) and contribute towards the implementation of the EU's 20-20-20 climate change abatement strategy by investing in renewable energy. The Marguerite Fund's core backers have so far been joined by Malta's Bank of Valletta, Portugal's Caixa Geral de Depósitos and the European Commission.

The CDP, CDC and EIB are also teaming up with Morocco's Caisse de Dépôt et de Gestion (CDG) and Egypt's EFG-Hermes Holding to develop the Inframed Fund, dedicated to long-term investments in sustainable urban, transportation and energy infrastructures in Southern and Eastern Mediterranean countries. The fund's resources total € 400 million.

4.4. Public Financial Intermediaries (PFIs)

Public Financial Intermediaries are public financial institutions which, in a centralized fashion, provide investment products and services to other (public) decentralized financial institutions. This business model is strongly linked to the public banking sector's structure in Germany.

Due to the fact that banking laws and regulations generally do not allow savings banks to hold equity participations or to perform risky investments, and since Sparkassen are often of extremely limited size, the Landesbanken provide the Sparkassen with complex, non-standard products and services tailored to the investment needs of their customers.

Second, the Landesbanken act as central banks and clearing houses for the Sparkassen within their region, providing emergency liquidity and settlement services to them. Indeed, a peculiarity of the German banking system is the existence of so-called 'giro networks', referring to *"payment procedures which are used within one banking group or within a bank's branch network. Settlement is effected by one or more of the banking group's central institutions"*[35].

At the national level, DekaBank, a financial institution owned by the Landesbanken and by the National Association of Savings Banks, in turn provides the Landesbanken and Sparkassen with central asset management services, offering investment products and services to the retail customers of the regional and local public banks. Contrary to the Landesbanken however, DekaBank does not have a central bank or settlement function.

This three-layered public banking system allows the strongly decentralized German banking market to operate efficiently by pooling together on a wide scale those services in which economies of scale and scope are dominant, while maintaining local managerial independence at the level of the individual savings bank. Other examples of PFIs are provided by the pooling of regulated savings by central institutions such as the Caisse des Dépôts et Consignations and the Cassa Depositi e Prestiti.

[35] See Bank for International Settlements, *Payment systems in Germany, Committee on Payment and Settlement Systems*, 2003.

4.5. Pan-European Multilateral Development Banks

Although they are not included in the analysis above, there are some major pan-European multilateral development banks, which are incorporated under international law. These include the following institutions:

4.5.1. European Investment Bank (EIB)

Historically established in 1958 by the Treaty of Rome to support the development and integration of economically weaker regions, the EIB has since broadened its mission and is now considered more generally the investment arm of the European Union, intent on furthering EU policy goals. Endowed with assets totalling € 362 bn (as of 2009), the EIB is geared mainly towards the following kinds of investment: packages to stimulate SMEs, measures designed to attain EU cohesion and convergence goals or fight climate change, funding for environmental protection or to guarantee energy security and sustainability, promote the growth of Europe's knowledge economy or develop trans-European networks. In particular, the European Investment Fund (EIF), controlled by the EIB and benefiting in its own right of the Multilateral Development Bank status, is a specialist provider of SME risk finance. The EIF does not however directly finance SMEs but rather provide funds to intermediaries such as banks and venture capital funds, which in turn will be involved in SME funding.

4.5.2. Council of Europe Development Bank (CEB)

Set up in 1956 to alleviate refugee problems, the CEB has progressively expanded its scope of action and is now devoted to bolstering social cohesion in Europe by financing social projects, acting on behalf of refugees (e.g. by making a donation to Georgia following the 2008 war in South Ossetia), migrants and displaced persons, but also by promoting social housing and enhancing the infrastructure of public services (among other things by building all-weather roads in Albania, expanding and upgrading the sewerage and drainage facilities in the Greater Nicosia Area, improving waste collection and treatment facilities in the Baltic states and building schools in Portugal).

4.5.3. European Bank for Reconstruction and Development (EBRD)

Founded shortly after the fall of Communism in Russia and Eastern Europe, the main goal of the EBRD was to help formerly Communist countries make the transition to a market economy and the establishment of private sectors. Its membership, totalling 61 countries, is roughly divided between financing members and recipients of investments. Acting in partnership with private companies, the EBRD provides project financing for banks, industries and businesses, under-

pinning the privatisation process, the restructuring of state-owned firms and the improvement of municipal services.

4.5.4. Black Sea Trade and Development Bank (BSTDB)

The BSTDB is the financial pillar of the organisation dubbed Black Sea Economic Cooperation (BSEC), whose 12 members are Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, Russia, Serbia, Turkey and Ukraine. It is an international financial institution supporting investors and companies with a regional focus on the Black Sea Region. *"The purpose of the Bank is to accelerate development and promote cooperation among its shareholder countries. BSTDB supports regional trade and investment, providing financing for commercial transactions and projects in order to help Member States establish stronger economic linkages."*[36]

4.5.5. Nordic Investment Bank (NIB)

Headquartered in Helsinki and co-owned by Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway and Sweden, the NIB borrows funds on the international capital markets and offers long-term loans and guarantees to private and public clients. Its main areas of focus encompass infrastructure and environment-enhancing investments. Moreover, in cooperation with other financial intermediaries, the NIB targets SMEs to help them grow and develop.

[36] See BSTDB website www.bstdb.org.

CONCLUSION

The existing literature on public financial institutions has two main shortcomings that are addressed by the present study.

Firstly, although many works discuss the performance of public banks, there is no clear definition of what actually constitutes a 'public bank'. Most existing studies use a single threshold (usually 50%) of ownership by public authorities as a definition of what constitutes a public financial institution. However, this approach presents some structural flaws because the use of a single threshold is an oversimplification that, as we demonstrated, obscures a broader diversity of existing ownership structures. At the same time, the use of an ownership-based classification utterly ignores the many situations in which ownership of an institution's equity does not entail actual decision-making power. Consequently, this study follows the more realistic IFRS consolidation rules, defining public banks in terms of an 'effective control' criterion.

A second shortcoming of the literature is that it provides no proper classification of the wide variety of existing public financial institutions. Yet this is essential, since the identification of an institution's objectives is a prerequisite for measuring its performance in terms of the degree to which those goals are being or have been attained. Our study aims to bridge this gap in the literature by providing a framework for classification based on an extensive analysis of the missions and roles of public financial institutions.

The starting point of our research project was to draw up an exhaustive list of public financial institutions in Europe, which for the purposes of this study, was taken to mean the 27 EU Member States plus Croatia, Macedonia, Norway, Switzerland and Turkey. To provide an exhaustive overview of the public banking sector in Europe thus defined, the study covers more than 80% of Europe's banking assets and identifies all those public financial institutions with public-sector involvement in excess of 5%. The mission statements of these financial institutions were collated and categorised along the lines of grounded theory. The resulting classification covered the respective public financial institutions' geographic scope, their stakeholders, products and services, and also their objectives.

Using the collected mission statement information, 4 categories of missions were identified on the basis of the two key dimensions of public banks' missions: their geographic scope (local vs. global focus) and the specificity of their objectives (specific vs. generic goals).

The first and second groups are composed of highly specialised public financial institutions providing specific products and services aimed at fulfilling strongly targeted objectives. The distinction between these two categories of institution is

that the first group is made up of banks fulfilling promotional missions, i.e. boosting exports, supporting SMEs and financing innovation, whereas the second group includes banks pursuing a general-interest mission, e.g. promoting sustainable development, social progress, education, agriculture and tourism.

The third group consists of banking institutions with a strong geographic focus. These types of institution (mostly regional and savings banks) are strongly rooted in their home region and mainly offer retail banking services.

The last of these groups comprises mainly financial institutions where the state only controls a minority interest. Most financial institutions of this kind are *universal banking groups* with a propensity for international expansion.

Based on this typology, we identified the main underlying economic rationales justifying public intervention in financial markets. Market failures necessitating public intervention in financial markets cover a whole range of economic phenomena: mitigation of negative externalities (such as systemic or export risks), reduction of information asymmetries (with respect to SMEs, innovation and municipal financing), maximisation of positive externalities (i.e. the promotion of socially desirable but financially unprofitable projects), compensation for short-sightedness on the part of the private sector (e.g. the construction of transport and energy infrastructure), and jump-starting financial and economic development in less privileged regions.

The final section of our study presented the most characteristic and/or widespread business models developed by public financial institutions to achieve their objectives. For each business model (national and regional development banks and agencies, municipal credit institutions, export credit agencies, long-term investors, public savings banks, and public financial intermediaries), we described the significant characteristics of their business environment, their activities and financing. We also showed the extent to which each type of public financial institution helps to mitigate the specific market failures listed above.

In conclusion, we would like to stress that the diversity of public financial institutions in Europe stems from their different goals and the inherent shortcomings of the private financial sector they set out to redress. This wide range of underlying economic rationales renders meaningless most performance-based analyses of public sector banks, since all that such analyses measure is financial performance (which presupposes the overriding aim of profit maximisation), neglecting all other kinds of objectives pursued by public financial institutions.

Based on this study's typology of economic rationales behind the operations of public financial institutions, further research is needed to develop new performance metrics that enable the accurate measurement of the degree to which public banks and funding agencies attain their respective objectives.

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