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The network of Germany's bank branches is dwindling

Author:
Kristin Bernhardt, University of Siegen
Dr Michael Schwartz, phone +49 (0) 69 7431 8695, research@kfw.de

Germany's banks are becoming fewer. Since 2003, over 4,500 branches – i. e. more than one out of every ten branches – have been closed down. The closures primarily concern Germany's rural and economically weaker regions.

It is likely that these cut-backs in the number of branches will continue. By 2020, there may be up to a third less bank branches.

Throughout this process, SMEs must still be able to access bank funding. Companies need to retain access to special, advisory-intensive activities (e. g. internationalisation, innovation).

The European banking landscape is changing

The European Central Bank (ECB) recently announced that the banking landscape is thinning out in the Eurozone: 269 banks either closed down or were merged in 2013 (-4 %).[1] The banking sector is likewise changing in Germany, where the ECB reports that the number of financial institutions declined by 31 year-on-year. This goes hand-in-hand with "bank branch death"[2], given that in nearly all cases, the elimination of a financial institution leads to a reduction of the branch network.

In addition, existing credit institutions are cutting down on the number of branches they have, in some cases significantly. This trend is observable for a good few years now. What was not clear until now is whether the reductions concern all the regions of Germany to the same degree, or whether – contrary to the general trend – local branch networks have actu-

ally been expanded in some cases. This article shows just that. An additional question arises as to the connection between a region's network of bank branches and regional economic development; *KfW Economic Research*, in collaboration with the *University of Siegen*, conducted a study on both these questions.
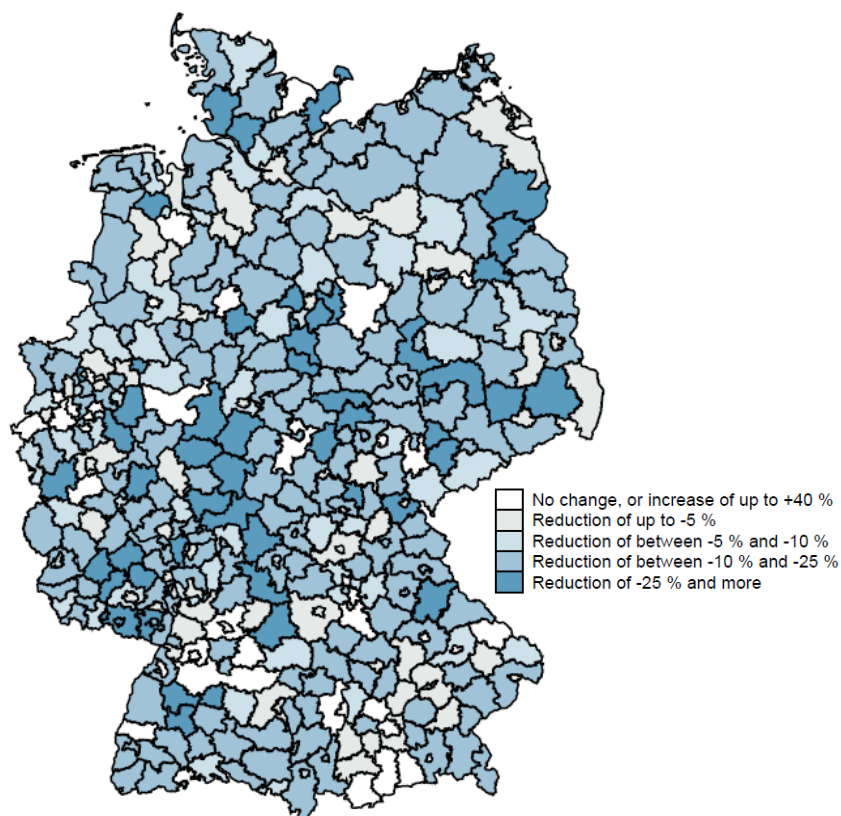
One out of every ten bank branches in Germany closed down

Between 2003 and 2013, Germany's network of bank branches markedly contracted in size: over 12 % – more than 4,500 branches – were closed down. Currently, around 30,100 branches remain. By way of comparison, France has over 38,450 branches – Spain over 38,200, with the numbers in a downtrend (-17 % between 2008 and 2012).[3]

For the most part, cost-cutting (and profitability raising) considerations (particularly the fixed costs of real estate and

Figure 1: Changes in the number of bank branches between 2003 and 2013

Relative changes in 2013 with respect to 2003 as a percentage; 402 districts and independent towns

No change, or increase of up to +40 %
Reduction of up to -5 %
Reduction of between -5 % and -10 %
Reduction of between -10 % and -25 %
Reduction of -25 % and more

Sources: Hoppenstedt Bankenortslexikon (Hoppenstedt regional listing of local banks), German Federal Office of *Statistics, own calculations.*

personnel) are behind the trend. Increasing professionalisation and the elimination of surplus capacities are other important causes, however. Mergers between banks (Commerzbank and Dresdner Bank being the most prominent example) likewise lead to branches being shut down to avoid duplications among local structures. The "Digital Revolution" in banking also plays a significant role; both in terms of increased competition due to the rise of online banks, as well as the fact that (private) banking clients are increasingly turning to digital distribution channels for more and more financing and investment products.[4]

Bank branch networks are thinning out in the countryside …

Branches closures are not evenly distributed among Germany's regions. While diminishing branch networks can be observed in over 4/5 of Germany's 402 districts and independent towns, in 17 of them the number of bank branches has not changed (e. g., cities of Kaiserslautern, Kassel or Darmstadt). Moreover, the banking market is actually growing in 48 of the regions. The district of Augsburg and the city of Heilbronn are ahead of the pack here, with the number of bank branches up 67 % in both regions.

This analysis shows that rural districts are more often affected by the trend towards scarcity than cities are. Take, for example, the district Südliche Weinstraße, where the number of branches dwindled from 70 to 42, a -40 % decline. Certain cities are nonetheless affected by the cutbacks, such as Hamm, which

registered a -33 % decline.

Overall, however, it is clear that particularly rural regions are feeling the changes. While in 2013 there were 15 % fewer bank branches in rural regions than 10 years ago, the number in the cities "only" went down by around 9 % in the same period. It seems as though the more urban (rural) a German region, the fewer (more) branches shut down (see Figure 2).

… as well as in economically weaker regions

Regions with relatively less economic strength are likewise more markedly affected by the cutbacks (see Figure 3) and are characterised by twice as many branch closures per capita than regions with comparatively stronger economies (-12 % versus -6 %). This finding is in line with current scholarly debates on the significance of the development of a region's financial sector and the success of that region in economic terms.[5]
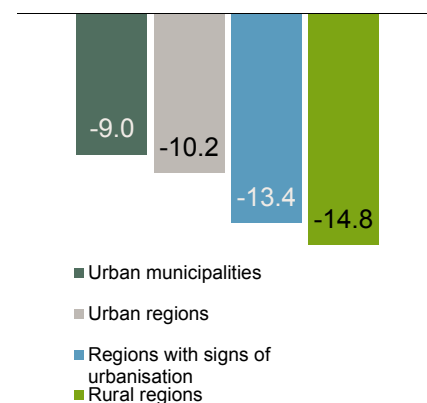
Local bank branch networks are less dense in many cases – are there consequences?

The decline in the number of bank branches is not without consequences for the structure of regional banking markets. *In the first instance*, a decline in absolute terms leads to lower branch densities (per km²). In numbers, this means that if in 2003, a region still had 86 branches on average, by 2013 the number had come down to 75.

Furthermore, this development has an

Figure 2: Changes in bank branches by type of region (2003–2013)

Relative change as of 2013 with respect to 2003 as a percentage

- ■ Urban municipalities
- ■ Urban regions
- ■ Regions with signs of urbanisation
- ■ Rural regions

Note: Regions have been categorised according to the German Federal Office for Building and Regional Planning's basic structural region types in terms of settlement. Independent towns not subordinated within a district form an additional category.

Sources: Hoppenstedt Bankenortslexikon (Hoppenstedt regional listing of local banks), German Federal Office for Building and Regional Planning, German Federal Office of Statistics, own calculations.

impact on bank accessibility. Econometric models[6] show that the reduction of a region's branch density by one unit increases the average distance to the next branch by almost five kilometres. A bank branch's average reachability diminishes. This is noteworthy because certain empirical studies have found a relationship between the spatial distance between firms and bank branches, and the quality and quantity of financial services they receive.[7] At the end of the day, according to prior studies by KfW, what counts for an SME in Germany above all else is the availability of a personal point of contact at the bank affiliated with their business, along with the continuity of that contact.[8]
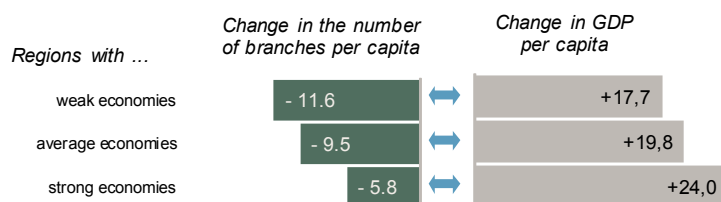
Greater scarcity of services offered locally?

When local branch density decreases, concentration in the regional banking market rises significantly[9], i. e. in some cases the variety in supply in the region undergoes a sharp decline (see Figure 4).

According to the KfW SME Panel[10], this has not had any negative impact on financial terms and conditions in recent years, which are good by historical

Figure 3: Is there a connection between economic strength and bank branches?

Relative change 2012 (GDP per capita) and 2013 (number of branches) with respect to 2003 as a percentage

Regions with …	Change in the number of branches per capita	Change in GDP per capita
weak economies	- 11.6	+17,7
average economies	- 9.5	+19,8
strong economies	- 5.8	+24,0

Note: Values are expressed on a per capita basis so as to exclude the impact of migration trends. Regions' initial classification by 2003 GDP per capita: "Low economic strength": Regions in the lower 10 % (less than EUR 20,000 per capita) of the distribution. "High economic strength": Regions in the upper 10 % (over EUR 45,000 per capita) of the distribution.

Sources: Hoppenstedt Bankenortslexikon (Hoppenstedt regional listing of local banks), German Federal Office of Statistics, own calculations.

standards. The antitrust authorities in some countries such as the USA nonetheless actively monitor bank density. Particularly smaller SMEs have few financing alternatives, often leading them to (have to) accept more unfavourable terms.
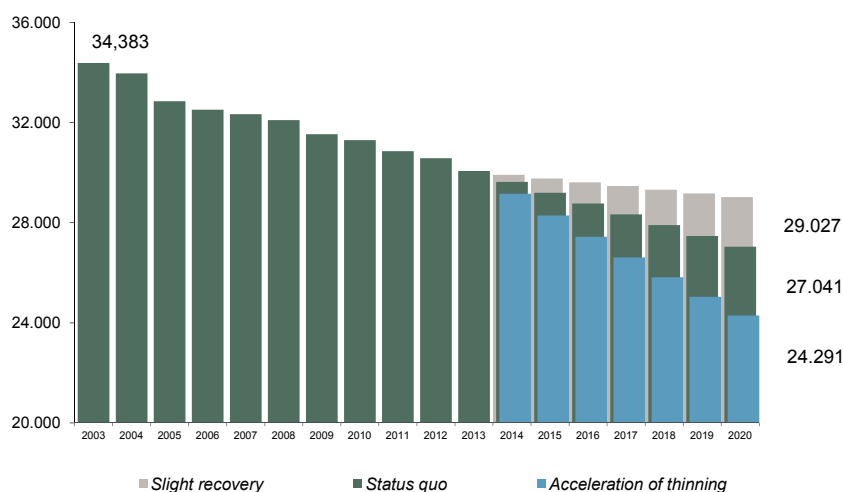
Location attractiveness equally important for banks and the real economy

The changes to date in the banking landscape have already been huge. A reversal of this trend may be ruled out. The way a regional financial market is structured usually reflects the respective region's economic development. Thus, each is influenced by the other. The development of a region in terms of its economic strength often runs parallel to the development of its banking market. This is also shown by statistically significant relationships.[11]

A one % increase (decrease) in bank concentration is accompanied by:

● A decrease (increase) in local annual business start-up activity by 2.4 start-ups per 1,000 inhabitants;

● A decrease (increase) in the number of local businesses by 6.3 businesses per 1,000 inhabitants;

● A EUR 570 per capita decrease (increase) in the regional GDP.

Figure 4: Banking-sector concentration in Germany 2003 and 2013

Herfindahl-Hirschman Index (HHI) for districts and independent cities (0= no concentration; 1= pure concentration)

HHI of over 0.277 (max. 0.56)
HHI of between 0.161 and 0.215
HHI of between 0.215 and 0.277
HHI of up to 0.161 (min. 0.041)

Note: Concentration in regional banking markets was calculated based on the so-called Herfindahl–Hirschman Index (HHI) as the standard gauge of concentration. The HHI assumes values between 0 (0 %) and 1 (100 %), with 1 representing a regional monopoly. The categorisation used here is based on the 25 % percentiles in the distribution of the HHI for the year 2003 at the district level. The HHI value is lower at lower levels of aggregation (administrative district vs. Federal State). By way of comparison, In the USA, the antitrust authority prohibits further mergers at an HHI limit value of 0.18.

Sources: Hoppenstedt Bankenortslexikon (Hoppenstedt regional listing of local banks), German Federal Office of Statistics, own calculations.

However, changes in bank concentration are often greater. An extreme example is provided by the district Harz, where be-

tween 2003 and 2013 concentration increased by 20 percentage points.

Access to bank loans must remain open for SMEs

The significance of the changes shown above to SMEs in Germany lies in the latter's traditionally strong ties to the banking sector: bank loans are by far the most important source of external financing for investment. A little over 1/3 of investment volume among SMEs stems from bank loans. On average, each year 643,000 SMEs – or 36 % of all small to medium-sized investors – apply for investment loans from banks or savings banks (2006–2012). Here too a downtrend is discernable, however. Bank loans (for purposes of investment or liquidity provision) – and, by extension, demand in regional banking markets – will likewise continue to be of great significance going forward, however. The volume of new instruments for financing investment on the part of SMEs is still very small.

Figure 5: Trend in absolute number of bank branches up to 2020

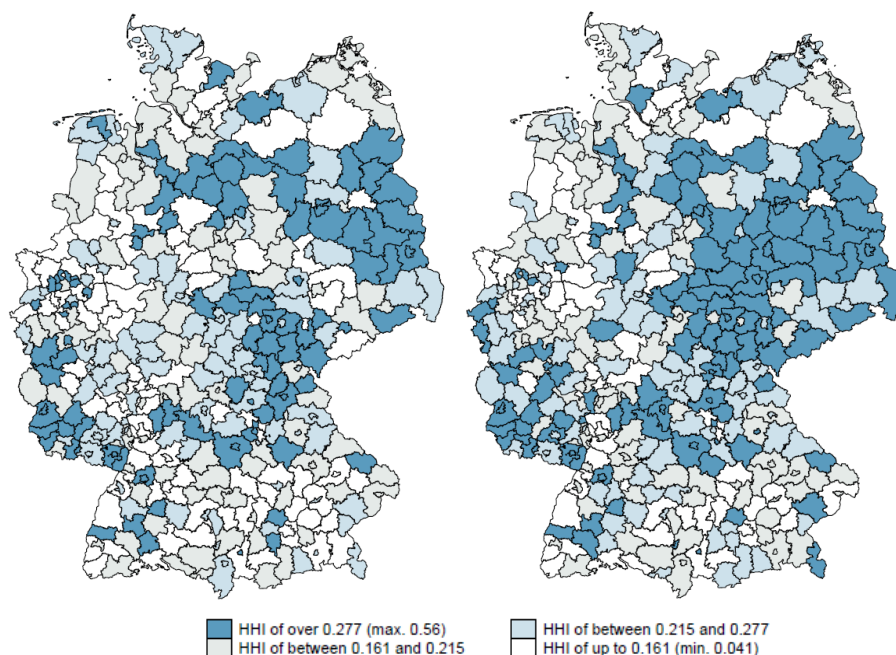*Slight recovery* *Status quo* *Acceleration of thinning*

Note: Linear continuation of the number of bank branches. "Status quo" represents a 1.5 % annual decline in bank branches. "Slight recovery" represents an 0.5 % annual decline. "More acute scarcity" represents a 3 % annual decline.

Sources: Hoppenstedt Bankenortslexikon (Hoppenstedt regional listing of local banks), own calculations.

In order to remain competitive, SMEs must above all still have recourse to advisory-intensive activities with higher than average financing requirements, innovation and internationalisation being examples. These services need to be secured, even if a local branch closes down. Thus, at the present time 37 % of SMEs active in innovation already indicate that a lack of suitable external sources of financing is a factor standing in the way of innovation.[12] And financing limitations in starting up and expanding international operations currently pose a problem for one out of four SME owners.[13]

Outlook: 10,000 fewer bank branches by 2020?

According to the German Bundesbank, the observed decline in bank branches in Germany – as in other European countries[14] – is mainly due to the elimination of surplus capacities in the domestic banking market.[15] The resultant fierce competition is cited as the reason for the structural weakness in profitability on the part of German banks compared to their international peers. The Bundesbank has this to say on the matter: "This is why banks need to be eliminated from the market and overcapacities need to be reduced in an orderly fashion."[16]

A trend towards further branch reductions is therefore to be expected with a reversal being highly unlikely. The most recent example is HypoVereinsbank which has announced that it still may eliminate half its remaining branches in the future.

If we assume that the degree of contraction will remain constant, by 2020, 20 % of branches that existed in 2003 will have been closed down. If we assume a "slight recovery", there will be 16 % fewer branches. However, if we assume "more acute scarcity", there will be 29 % fewer bank branches by 2020.

Conclusion

The present study alerts to the fact that efforts to reduce the number of bank branches have not yet run their course, and that they are accompanied by deteriorations in regional economic structures. This does not currently represent a problem in terms of credit supply to SMEs in Germany. However, banks must in the future continue to offer SMEs advisory-intensive financial services, which are important if the SMEs are to remain competitive. ∎

Database:

The banking data used in the present study was compiled on the basis of *Hoppenstedt Bankenortslexikon (Hoppenstedt regional listing of local banks – HB)*, as of 30 June in any given year (accessible via the *German National Library*). Due to the nature of the inquiry, only ordinary bank branches (ones that employ staff and are open full-time) were taken into consideration. Service centres, paying agents, bank buses and the like were not taken into account. In addition, any duplications (e. g. if a branch is listed as both a corporate client centre and a real estate centre) were eliminated. Furthermore, HB does not maintain any data on Postbank branches, nor was any such data available upon request from Postbank AG.

The regional data used in this study was based on the 402 German administrative districts that existed as of 2012. Population figures, GDP and area data were taken from the *German Regional Data Bank* made available to the public by the Federal Office of Statistics. Changes made to administrative districts and the like were taken into account.

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[1] European Central Bank (2014), press release: Decline in the number of monetary financial institutions continued in 2013, 21 Jan, 2014. [http://www.ecb.europa.eu/press/pr/date/2014/html/pr140121.en.html]

[2] Frankfurter Allgemeine Zeitung (FAZ) (2014), "Bank branch death continues", 28 Jan, 2014, p. 17.

[3] "Handelsblatt" newspaper (2013): "Europe's banks thinning out their branch network", 12 Aug, 2013.

[4] Bain & Company (2013), Customer Loyalty in Retail Banking: Global Edition 2013. What it takes to make loyalty pay off.

[5] For example, cf. Guiso et al. (2004): Does local financial development matter?, The Quarterly Journal of Economics 119, S 929–969. Rajan, Raghuram G. und L. Zingales (1998): Financial Dependence and Growth, American Economic Review, Vol. 88, no. 3, pp. 559–586. Beck and Demirguc-Kunt (2006): Small and medium-size enterprises: Access to finance as a growth constraint, Journal of Banking and Finance (30), S. 2931–2943.

[6] For in-depth analysis, see Beck, G. and K. Bernhardt (2014): *Does the local banking market structure matter?*, Working Paper.

[7] Allessandrin et al. (2009): Banks, Distances and Firms' Financing Constraints, Review of Finance (13), pp. 261–307. Degryse, H. and S. Ongena (2005): Distance, lending relationships, and competition, The Journal of Finance 60.1, pp. 231–266.

[8] Zimmermann, V. (2013), Unternehmensbefragung: Trotz schwacher Konjunktur Unternehmensfinanzierung stabil, KfW Economic Research, Frankfurt am Main.

[9] Concentration in regional banking markets was calculated based on the so-called Herfindahl–Hirschman Index (HHI) widely held to be the standard gauge of concentration. The HHI assumes values between 0 (0%) and 1 (100%), with 1 representing a regional monopoly. In the USA, the antitrust authority prohibits further bank mergers at an HHI limit value of 0.18. A change by one unit signifies +/- 0.01 points.

[10] Schwartz, M. (2012), 2012 KfW SME Expert Panel: Starke Performance – Höhere Risiken, KfW Economic Research, Frankfurt am Main. See in particular Figure 13 and the relevant passages of text.

[11] For in-depth analysis, see Beck, G. and K. Bernhardt (2014): *Does the local banking market structure matter?*, Working Paper.

[12] Cf. Zimmermann, V. (2014), KfW's 2013 SME Expert Panel: Innovationen, Steht der Mittelstand endlich in den Startlöchern?, Fokus Volkswirtschaft Nr. 42, KfW Economic Research, Zimmermann, V. (2012), *Innovationshemmnisse im Mittelstand*, KfW Research, Fokus Volkswirtschaft, Nr. 6, September 2012, pp. 1–2.

[13] Cf. Brutscher, P., Raschen, M., Schwartz, M. and V. Zimmermann (2012): Internationalisierung im deutschen Mittelstand. Step by Step zum Global Player. KfW Research, KfW Bankengruppe, Frankfurt am Main.

[14] A glance at the number of bank branches per 1 million inhabitants (branch density) shows that Germany's major neighbouring states likewise exhibit a high or even higher bank branch density: The Bank for International Settlement (BIS) reported that Germany had 485 branches per million inhabitants in 2011; in France the figure comes to 586; in branch density in Italy is as high as 779 branches per million inhabitants. Here too, existing overcapacities are being eliminated by cutting down the number of branches.

[15] Cf. Finanzstabilitätsbericht 2013, Deutsche Bundesbank.

[16] Cf. Finanzstabilitätsbericht 2013, Deutsche Bundesbank, p. 55.