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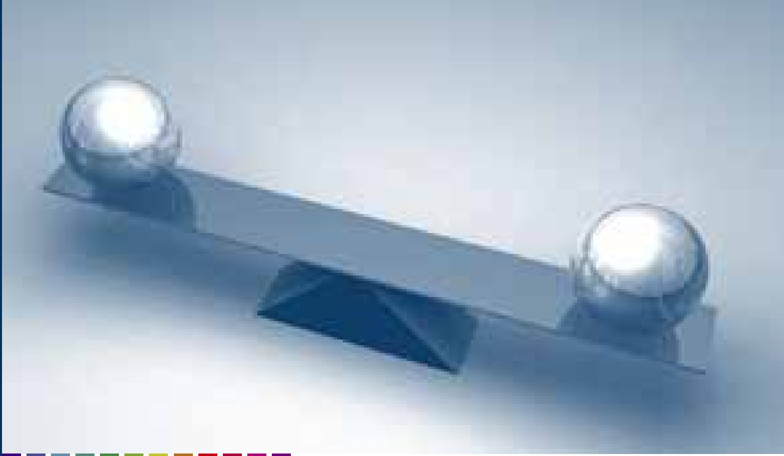
PERSPECTIVES



BALANCED STRUCTURAL POLICY: GERMAN SAVINGS BANKS FROM A REGIONAL ECONOMIC PERSPECTIVE

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BALANCED STRUCTURAL POLICY: GERMAN SAVINGS BANKS FROM A REGIONAL ECONOMIC PERSPECTIVE

Dr. Stefan Gärtner

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Preface to the English edition

This study focuses on regional structural policy and the role played in it by region-specific banks. An empirical analysis of the German savings banks [*Sparkassen*] examines whether such banks can be successful and their significance in regional structural policy. Without anticipating the content of the following pages, savings banks can succeed. In fact, they can do much more: Germany's decentralised savings banks contribute to the stability of the financial market.

The following is an abridged version of a doctoral thesis written between 2005 and 2007, and published in Germany in 2008. Although the study has a regional and not a financial focus, it also found that regional banks which check capital mobility and have long-term relationships with and obligations to their customers stabilise financial markets. These findings have become particularly topical in the current financial crisis, which has confirmed their truth at least as regards Germany's savings banks. German savings banks have long been criticised by the European Commission as, operating solely within set regional boundaries, they stand for anything but the model internal market and financial market integration. "The traditional hypothesis on the relationship between financial integration and financial stability has been that financial integration and globalisation would dilute risks and reinforce financial stability." (Commission of the European Communities 2009: 58). Since the financial crisis began, however, there have been growing signs of a rethink: the Commission questioned its market philosophy for the first time in the European Financial Integration Report released in January 2009. "The financial crisis has offered a live demonstration that financial globalisation may indeed amplify the original financial shock." (Commission of the European Communities 2009: 58). In effect, the quantitative empirical analyses presented here prove that the risks run by Germany's decentralised savings banks are indeed low, and when Robert Wade (2008) from the London School of Economics suggests a suitable response to the financial crisis is not simply better regulation but also the creation of regional financial intermediaries focussed more on customer care and less on profit maximisation, he is advocating something very similar to the German savings bank system.

Savings banks are relatively small and have a higher concentration risk due to their regional loan portfolios, yet are nevertheless successful and contribute to financial market stabilisation. This can be explained by factors such as geographical and mental proximity and a sense of responsibility for staff and the region, in other words factors which are disregarded in financial market theory and which cannot be recorded using the analytical tools applied by major banks and rating agencies. The financial crisis offers the chance to put aside traditional dogmata for a debate on companies' social and regional responsibility, on the role of a State which stimulates and supports but also regulates, and on the importance of regional diversity in Europe. The world of science as well as political and social groups should exploit this window of opportunity. In the context of this debate, savings banks could provide inspiration both for European regional development and for the architecture of stable financial markets.

Acknowledgements: Many people contributed to this study. They are listed below in alphabetical order, without their titles or the institutions to which they belong: Hermann Bömer, Heinz Brödner, Dorothee Chini, Jan Fasselt, Hartmut Forndran, Julia Finke, Dagmar Grote Westrick, Christoph van Gemmeren, Gerd Hennings, Klaus R. Kunzmann, Klaus Krummrich, Nancy Lockkamper, Wiebke Lang, Christian Meier, Chris De Noose, Carmen Oehler, Dieter Rehfeld, Jörg Siegmann, Eleanor Small, Judith Terstriep, Thorsten Wehber, Marco Zieger.

I would also like to thank the experts interviewed as part of this study, those I spoke to from the *Sparkassen* Darmstadt, Dortmund, Biberach and Altmark West and the representatives of the four participating cities and districts (a list of names can be found in the appendix).

BALANCED STRUCTURAL POLICY: GERMAN SAVINGS BANKS FROM A REGIONAL ECONOMIC PERSPECTIVE

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List of abbreviations

UR	Unemployment Rate
BBR	German Federal Office for Building and Regional Planning
GDP	Gross Domestic Product
CIR	Cost/Income Ratio
DBB	*Deutsche Bundesbank* [German Central Bank]
ATA	Average Total Assets
DSGV	*Deutscher Sparkassen- und Giroverband* [German Savings Bank Association]
ROE	Return on Equity
GATS	General Agreement on Trade in Services
Helaba	*Landesbank Hessen-Thüringen* [regional federal state bank]
IGZ	*Innovations- und Gründerzentrum* [Innovation Centre]
IT	Information Technology
IMF	International Monetary Fund
SME	Small and Medium-Sized Enterprises
NEG	New Economic Geography
OSGV	*Ostdeutscher Sparkassen- und Giroverband* [Eastern German Savings Bank Association]
ReDev. Indicator	Regional Development Indicator
ROG	*Raumordnungsgesetz* [Regional Planning Act]
SVC	SparkassenVentureCapital Dortmund GmbH
WTO	World Trade Organisation

PART A - INTRODUCTION

INTRODUCTION

Unequal regional and local development within a national economy or union of states creates regional economic disparities. In the twentieth century, rural areas were traditionally seen as structurally weak and were the focus of regional equalisation measures. Now, however, spatial disparities are more complex; it is no longer possible to determine a clear pattern of urban areas as winners and rural or peripheral areas as losers. Space, perceived quality of life, images and the economic infrastructure all determine regions' regional economic prosperity on both sides of the urban-rural divide. Some agglomerations, especially old industrial areas, are now weaker than rural peripheral areas and even prosperous cities have individual districts which have no share in economic and social development in the city as whole.

In the past, State regional structural policy tried to boost local development by encouraging companies to move into weak areas. Persistently low economic growth rates, an ageing and declining population, little to no business potential, the particular challenges posed by German reunification and increasing international economic integration now call for a major shift in structural policy. Structural policy players at all levels are discussing approaches such as "cluster" or "competence field" policy to work more on fostering existing local competences (Beetz 2006: 15, Perlik/Messerli 2001), in particular for eastern Germany (e.g. Dohnanyi, 2004). A more growth-focussed structural policy is designed to develop growth potential important to the national economy as a whole. Relevant structural political potential is not determined solely from a regional perspective; the policy also considers competitive global economic growth poles. This means that while all regions offer some potential, the relevant competences are largely to be found in the prosperous regions.

Although the general hope is that growth potential developed in central areas will *spill over* to weaker regions, such a policy change will in fact most likely put weaker regions at an initial disadvantage.[1] This conflict between growth and equalisation objectives exists not only in Germany, but increasingly also – as a result of the Lisbon Agenda – in the European Union as a whole (e.g. Hahne 2005: 257).

Such a policy shift could initiate growth processes in overall economic terms; however there is a danger that the absence of those regions no longer funded will be strongly felt in any future spatial innovation system. It must also be noted here that *ex ante* assessments of regions' development are in any case extremely difficult. There is thus a danger that support be cut off from some regions which would otherwise have had the potential to drive their own economic development in future, and the risks of socio-political rejection with the costs it brings for the economy as a whole are extremely high.

A logical response to this situation is a structural-political concept aimed at both growth and equalisation; in other words, a concept which both supports growth potential of national economic importance and puts in place targeted development measures for weak areas; a concept which attempts to prevent cumulative cycles. Such a structural policy must be able to meet differing regional requirements and, as national politicians cannot create such a policy on their own, there is a need for regional stakeholders who are ready and able to work on location development on the ground.

Germany's decentralised savings bank system can play a key role here. Savings banks are based in every region, regionally independent, bound to the region and can only lend money deposited with them in the region in which they operate (the principle of regionalism). They thus prevent an outflow of capital into prosperous regions. This study will address the question of *whether these public regional banks could help develop growth potential whilst promoting equalisation*, a question which has to date been more or less disregarded – despite the fact that banks play a key role in regions' economic development and insufficient access to the credit markets can block regional development. Companies cannot develop properly in structurally weak regions if there is a lack of banks. This in turn means banks are less interested in these regions and the economic gap between weak areas and the economic centres widens even further.

1 The question of whether or not the growth effects from prosperous regions spread to structurally weak areas was already discussed as part of polarisation theory (Myrdal 1969) from the 1960s to the 1980s (Dybe 2003: 15).

Yet even when there are banks in all regions, as the savings bank system guarantees, the institutions can only contribute to regional equalisation if they are able to generate similar returns in structurally weak regions as they do in prosperous ones. In view of the principle of regionalism which prevents savings banks from operating outside their own geographical business area, this condition appears unlikely to be met.[2] It seems obvious – upon initial consideration at least – that savings banks will generate lower returns in weak peripheral regions, hence provide less support for regional development and possibly even exacerbate the regional prosperity gap.

This study is based on the debate surrounding the consequences of a more growth-focussed structural policy and how to create a structural-political concept with both growth and equalisation aspects in line with specific regional strengths and weaknesses. Savings banks are examined within this framework as important structural-political stakeholders.

Cooperative banks have a similar function and structure to savings banks but this study has focussed on the latter for the following reasons: firstly, German savings banks are public organisations; the State has at least indirect power and there is therefore some question about their legitimacy from a structural-political perspective. Secondly, savings banks as public institutions are under constant attack from private banks and the EU Competition Commission; the question of their use is therefore of particular significance. Thirdly and lastly, savings banks have – with very few exceptions, where the local *Landesbank* [regional federal state bank] has taken on the savings bank's function – relatively large shares of the market in all regions of Germany. This is in contrast to the cooperative banks which are strongest in rural western Germany.

The situation outlined above raises the following key questions on which this study is based:

Question 1: What effects do changes in regional science and structural-political approaches have on the region and what role could regional banks play as implementers of a balanced structural policy?

In response to this question, relevant spatial economic and banking theories will be discussed and compared in Part B of this study. This will form the basis for an analysis of the effects of new structural policy and an examination of savings banks as local players.

2 This is in view of the fact that there is no savings bank equalisation fund and that savings banks can only use their own regional business potential.

Question 2: What is the function of savings banks in terms of competition, banking and the regional economy?
Part C describes savings banks in their role as structural-political players, analyses banking structures and discusses the effects of public regional banks on competition, banking and the regional economy. Possible disadvantages of savings banks' regional ties are also examined.

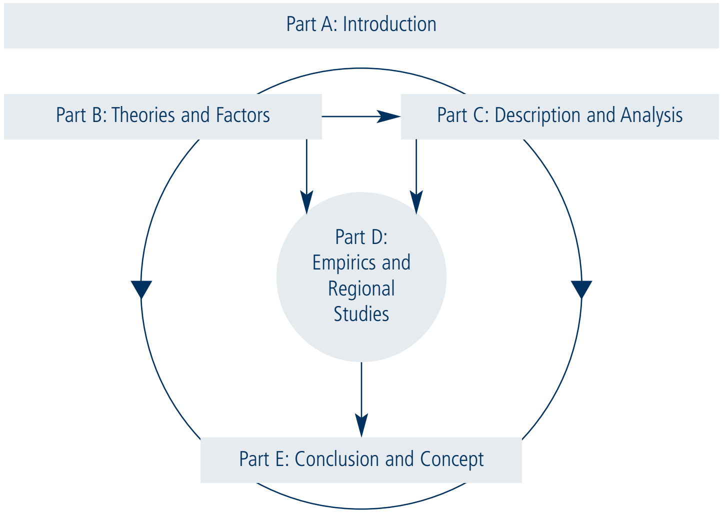
Question 3: What form does savings banks' structural-political commitment take on the ground? Are savings banks also able to contribute to regional development in weak regions?
Part D of this study contains the key empirical analyses, examining first the link between regions' economic status and the returns generated by savings banks. All approx. 470 savings bank areas are examined to establish the correlations between high savings bank returns and regions' economic strength. Implementation of structural policy on the ground is also analysed on the basis of a qualitative examination of four regions and the savings banks which operate in them.

Question 4: What form should a structural policy aimed at growth and equalisation take and how can such a policy be supported by the savings banks?
The final section, Part E, outlines how a balanced structural policy could be created and supported by the savings banks.

The content and structure of the study are presented in Figure 1. The contextual structure of the study is as follows: Part B sets out the basis for what follows by outlining theories and spatial factors. Part C has a descriptive and analytical function, presenting the specific structure, significance and role of savings banks for the banking market and regional development. Part D forms the empirical basis of the study and presents both quantitative analyses covering all savings banks and four regional studies. The closing section, Part E, proposes a possible conceptual model.

Figure 1: Study outline

A	Introduction	
B	Area and Banks: Theories, Policies and Effects on the Area	
	1.	Spatial Economic and Banking Theories
	2.	Structural Policy, Effects and Players
C	Savings Banks: Structure, Function and Market Position	
	3.	Savings Banks and their Role on the Banking Market
	4.	Savings Banks from a Competition, Regional Economic and Banking Theory Perspective
	5.	The Principle of Regionalism: The Disadvantages of Regional Ties
D	Savings Banks and the Region: Empirics and Regional Studies	
	6.	Savings Banks' Spatial Environment and Returns
	7.	Regions and their Savings Banks
E	The Challenges of a Balanced Structural Policy	
	8.	Savings Banks as Players in a Balanced Structural Policy
	9.	Conclusion



As regards methodology, the study is based on an evaluation of specialist literature and interviews with experts, an analysis of selected regions and savings banks and empirical statistical processes used to develop specific indicators.

PART B - REGIONS AND BANKS: THEORIES, POLICIES AND EFFECTS ON THE AREA

Regions and Banks: Theories, Policies and Effects on the Area

Structural policy in Germany traditionally focussed on attracting new companies and businesses. It was in the past chiefly concerned with peripheral rural areas but has undergone fundamental changes since the 1970s with the introduction of approaches such as *regionalised structural policy* and *endogenous regional development*. In many federal states, policy now increasingly takes account of locally available potential. This has not signalled the end of traditional structural policy, however, but rather the use of supplementary or parallel approaches. A further change in direction began around a decade ago: as part of *cluster* or *competence field approaches*, experts are currently debating concentrating competitive potential at a national or supraregional level albeit in the light of locally available potential.

Competitive potential is not, however, equally distributed and is less concentrated in structurally weak areas. Neither the academic nor the political debate has addressed the consequences such a new structural-political approach would have for structurally weak areas (Hübler 2005: 57, Rehfeld 1999: 247), this despite the fact that the growth pole debate in polarisation theory (Myrdal 1969) from the 1950s to the 1980s would provide a useful starting point. The question then as now is whether the results of such a structural political shift would sharpen or balance out the economic differences (Dybe 2003: 15).

In structural-political terms, the development of potential on the ground is the very area where regional banks and the regional availability of credit play a key role. A lack of regional financial intermediaries can lead to a shortage of credit: banks in the centres do not have enough information on potential borrowers in the periphery, or assume that loan transactions in the periphery are smaller and the sums involved therefore unprofitable. As this hinders companies' development, these regions are thus in turn an unattractive business prospect for the banks. In flourishing centres, on the other hand, banks tend to concentrate and companies here therefore have better growth and development opportunities. This leads, at least in theory, to spatially concentrated cumulative effects (Porteous 1999) in which banks act as a form of catalyst.

It can also be assumed that banks with a regional focus not only function as financial intermediaries but also play a role in boosting the regional economy or implementing regional structural policy – not least as banks tied to the region must indirectly factor regional economic development into their business calculations (Dybe 2005: 218).

Banks and financial market systems are notwithstanding this situation almost never discussed in terms of spatial economic theory or regional economics. Although regional banks were implicitly considered by MYRDAL (1959, 1969) in regional polarisation theory, CHICK and DOW's claim in 1988 that "the tendency in the literature is to ignore financial factors" (1988: 219) is in essence still an apt description of current spatial economic theory.

Part B of this study examines the effects changes in regional science and structural-political approaches have on regions and the role regional banks could play as implementers of a balanced structural policy.

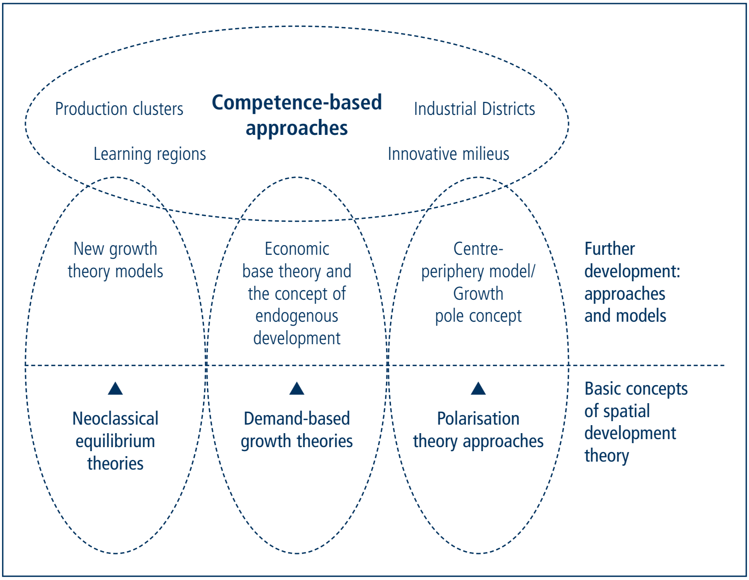
Developments in spatial economic theory, the factors influencing spatial structures and the effects of a competence-focussed regional structural policy will be discussed here in the light of financial and banking market conditions. The first chapter deals with spatial economic theories, in particular more recent regional economic approaches, and considers the role of banks in regional development. Chapter 2 outlines regional structural policy, discusses its effects and examines the players involved in implementation on the ground.

1. SPATIAL ECONOMIC AND BANKING THEORIES

In the past, spatial aspects played hardly any role in economic analyses and were considered in economic issues only in certain minor areas of geography or urban and regional economics (Krugman 1991: 3ff.). There was an assumption that perfect competition would lead to the optimum distribution of resources, and that mobility in production factors ensured balanced spatial economic development. It was therefore a long time before the discipline of *spatial economics* developed. Yet what was discovered in reality, namely that regions develop unequally, is a challenge to experts to establish the reasons why and create development concepts offering particular support for weaker regions.

Explanatory models and theories have not evolved solely over time and by region Alternative approaches have been developed which in some cases are complementary and in others diametrically opposed. To date, no universally applicable, workable spatial economic development theory has emerged (Schätzl 2001: 29; Axt 2000: 151). Spatial economic growth and development theories are all, notwithstanding their range and diversity, based on one of three basic concepts as shown below (Gärtner 2003: 58).

Figure 2: Competence-based approaches and spatial economic trends



Various different models and approaches have developed from these basic concepts, but at the same time a change of direction is also emerging in both structural policy and in spatial economics (termed "competence-based approaches" in the diagram above). Key aspects of this change are:

- the development of competence available locally;
- considering geographical space to a greater or lesser extent together with its socio-economic impact (Läpple 1998a: 69), in other words agglomeration effects, networks, inter-firm cooperation (Dybe 2003: 346), increasing scale effects (Krugman 1991, Fujita et al. 199), endogenous potential (Hahne/von Stackelberg 1994) and also cultural factors (Grote Westrick/Rehfeld 2006);
- a particular focus on knowledge spillover; there is a growing consensus that this depends on geographical proximity (Koschatzky 2002), and
- the strategic focus on a regional competition model in which the stakes are quality or competence.

These new approaches are described here as *competence-based approaches*, for they are different from both classic spatial economic theory and innovation theory and embrace a broader field. This term is not proposed as a more accurate universal description than those above, but in this specific case is a more suitable definition for the focus of this study.

The term shall be used in the following pages to cover approaches such as *innovative milieus* (Camagni 1991), *industrial districts* (Marshall 1919), *learning regions* (Florida 1995) and *production clusters* (Porter 1993, Rehfeld 1999) (see also Fig. 2). Unlike theory-based trends in spatial economics, competence-based approaches focus on empirical ad hoc explanations rather than closed models and, in contrast to the three spatial development theories (see Fig. 2), they analyse at a meso-level and not in overall economic terms. In other words, spatial development theories take interactions between companies as the basis for theoretical assessments of spatial distribution without considering further details; competence-based approaches on the other hand investigate the specific forms and intensity of interaction in individual areas.

The competence-based approaches are presented in the following sub-chapter (Chap. 1.1) and examined in terms of, regional competitiveness, growth and equalisation. The three basic concepts in spatial development theory (see Fig. 2) are then outlined and their relation to competence-based approaches highlighted (Chap. 1.2). As already mentioned, one of the weaknesses of regional economic theory is that it ignores banking systems, structures and theories and the availability of regional finance. Sub-chapter 1.3 will therefore approach banking issues in the context of spatial development. Chapter 1.4 closes with an assessment and comparison of the various different spatial economic theories and approaches, and the importance these give to banking structures and effects on regional development.

1.1. Competence-based Approaches in Regional Economics

Since the 1990s, there has been a rediscovery of geographical area in the various branches of economics. This u-turn in classic economics can be attributed to KRUGMAN, who began his book *Geography and Trade*, published in 1991, with the words "I more or less suddenly realized that I have spent my whole professional life as an international economist thinking and writing about economic geography, without being aware of it" (1991: 1).

"Rediscovered", however, does mean that economic theory did not always operate in a *spatial vacuum*. The political economist MARSHALL, for example, outlined the importance of geographical proximity and concentration to companies' success in the early 19th century (Marshall 1919). ALFRED WEBER'S (1909) works on location theory and those of PREDÖHL (1949) on foreign trade similarly addressed spatial issues. According to Krugman, area and geography did in any case always play a certain part in theory beyond classic economics. Even in the past, certain areas of economic geography, sociology, regional economics and political science considered economics in a geographical context; the works of MYRDAL (1969) or FRIEDMANN and WEAVER (1979) are just a few examples. The connection between geographical space and economics nevertheless remained largely ignored by the discipline as a whole (Koschatzky 2001: 2, Scheuplein 2001).

In recent years, however, economics as a discipline has been paying increasing attention to spatial aspects. Some attempts are now being made to model more complex circumstances on the basis of more realistic and spatially-oriented assumptions and thus to explain regions' economic development, yet the use of closed theories and econometric models to illustrate reality rapidly reveals their limitations. According to KRIEGER-BODEN, even most of the more recent models take regions to be homogeneous (2000: 20). The current spatial economic approaches presented are not subject to the demands of standardised theories and models. They can therefore be more open, including for example cultural factors, and consider the regions in their complete *setting*.[3]

3 The downside to this openness is that the approaches' extreme complexity makes them hard to apply. For example, the cluster approach – the most in line with market logic and thus the least open – is the one most commonly used whilst the other approaches, e.g. innovative milieus, are more frequently discussed at an academic level than actually applied in practice.

The concept of *networks* plays a key part in competence-based approaches. "Companies in networks operate in cooperative competition" (Lessat 1998: 266). The term "network" goes beyond the traditional connections created by and on the market, "yet unlike 'milieu' (…) company networks (…) are seen as the result of rational activities aimed merely at optimisation" (ibid.). There are many different network types and structures: vertical (along the value chain), horizontal (at the same level of the value chain) and diagonal (cross-sector) connections are all possible. Company-based categorisation can also be done by function, for example public bodies, research and educational institutions, suppliers and customers, as used by RITTER and GMÜNDEN (1999: 389ff.) for networks in the innovation process.

Companies can benefit from networks, for example through knowledge spillover, improvements in communication and the reduction of uncertainty (Genosko 1997). If networks in a specific region grow, in other words if a large number of players within a network are located in a specific region, the region in question benefits although the term "network" gives no indication of geographical proximity or regional embeddedness. It covers an abstract economic (Blotevogel 1995: 738ff.) or social area created by relationships between the players. The spatial dimension is nonetheless often implicit in economic networks as geographical proximity fosters cooperation structures and interaction; however the main focus is on companies and company interaction and not on geographical area.

Geographical proximity as a central element of competence-based approaches and the concentration of economic activities in one area can also be explained in purely economic terms, as in NEG (see Chap. 1.2.1). Concentrating economic activity in one area does in theory increase the physical distance to the market but the overall lower transport costs mean this is not of great influence. Based on the expected overall reduction of transport costs, it becomes interesting to concentrate economic activity and thus benefit from both the internal and external advantages of agglomeration (e.g. Zimmermann 2003: 23, Krugman 1991).

Agglomeration benefits and low transport costs alone cannot, however, explain the geographical concentration of economic activities (*Max-Planck-Institut zur Erforschung von Wirtschaftssystemen* 2001: 820). One important factor is that a common culture (standards, values, perspective) can develop if sectoral and regional focuses coincide. As the form of this common culture or ethical perspective and the relevant stores of knowledge can vary widely depending on sector and place, this results not only in the formation of agglomerations in general but also in geographical specialisation (Gärtner 2006: 40ff.).

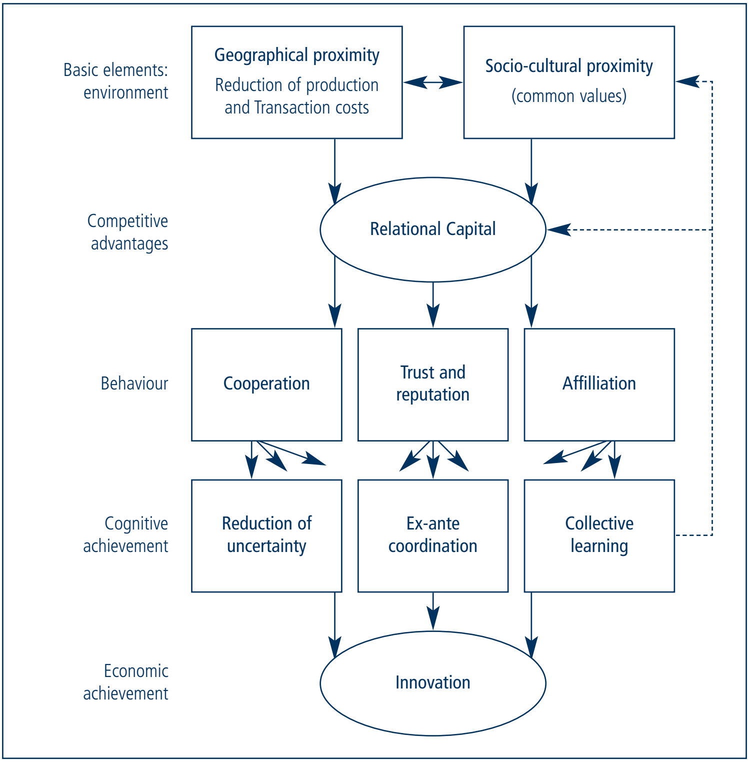
The findings and observations are part of a number of more recent regional and local economic concepts. Both the analytical basis of and approaches developed by individual concepts can overlap and a clear definition or demarcation is therefore not possible. Two of the approaches are outlined below. They represent, to a certain extent, the two ends of the scale in the question of whether theories focus more on economic (cluster approach) or cultural and social aspects (innovative milieus).

1.1.1. Innovative Milieus

The *innovative milieus* approach (e.g. Camagni 1991) was developed by the *Groupe de recherche européen sur les milieux innovateurs* (Gremi), founded in 1985. It gives equal weight to economic, technological, institutional and cognitive aspects and is based primarily on quantitative studies of parts of Italy (Perlik/Messerli 2001: 13). The approach sees the network of relations between the relevant players as a significant regional competitive advantage. GENOSKO emphasises that "despite the importance of *proximity* and spatial concentration, the milieu approach is a cultural and not a geographical one" (1997: 4ff.). Innovative milieus are based on a common basic understanding of socioeconomic problems and standard solutions and, although this is usually linked to a geographical area, they can also be bound to a *non-spatial* social context such as a business association. In his *functional area concept*, CAMAGNI also separates geographical from socio-cultural proximity, as shown in Figure 3. Socio-cultural proximity, which is responsible for common standards, values and attitudes, is shaped by geographical proximity and vice versa; both are fundamental elements in the creation of the relational capital which Camagni describes as a regional competitive advantage. Milieu is thus implicitly linked to region. This relational capital results in specific attitudes which promote innovation. A geographical area is considered particularly successful if it has such an innovative milieu and is able to exploit networks or social proximity.

A close reflection of the actual complexity of spatial structures, this approach is correspondingly difficult to apply both analytically and conceptually (Camagni 2003): on the one hand, any attempt to divide the complex factor *relational capital* into its constituent parts must necessarily remain extremely limited. Secondly, it is almost impossible to determine what effects these individual aspects actually have and, thirdly, many of these factors are extremely difficult to control.

Figure 3: Elements and functions of local milieus



Source: CAMAGNI 2003

CAMAGNI (2003) suggests considering *local governance* to help implement *innovative milieus* – an analytical approach used to explain why a particular region has developed innovatively or proved to foster innovation – in regional development and improve the competitiveness of a region or city. Local governance is understood as the totality of all rules, processes and attitudes which determine the management of communities.[4] Opportunities for discussion and interaction should be created, local or regional identity promoted and cooperation opportunities and trust generated. This requires both specific players and specific structures.

Even if the milieu approach is less likely to increase regional disequilibrium than other competence-based approaches, certain regions will be more suited to the approach than others, or as CAMAGNI puts it "it requires conditions that are rare and not all ubiquitous" (Camagni 2003). The innovative milieu approach therefore tends to act as a catalyst, a support, and will have more effect in regions where conditions are good to start with.

The milieu approach considers the interplay between the economic, social and cultural factors which, in the light of spatial proximity, create competitive advantages. Unlike in the cluster concept described below, companies' positions in a value chain and the competition between them are of secondary importance only.

1.1.2. Production Clusters in a Regional Context

The cluster approach has become extremely popular over recent years and is often discussed as a panacea for a wide range of development problems.[5] ROSENFELD, for example, writes that "conceptually, industry clusters have become the sine qua non of economic development policy in many parts of the world" (2002: 5). The term is used in a fairly general way[6] and the analytical must therefore first be separated from the strategic approach.

4 For a discussion of this term, see also Fürst/Zimmermann (2005).

5 In particular as concerns the continuing development problems in eastern Germany, there are increasing calls for funds to be concentrated on growth centres or clusters but no open discussion of the consequences this could have for less competitive areas (e.g. Tiefensee 12/03/2006, Bundesministerium für Verkehr, Bau- und Wohnungswesen [German Federal Ministry of Transport, Building and Urban Affairs] 2004.

6 Martin and Sunley (2003), for example, criticise the cluster concept as chaotic; they claim the term is too vague and has no clear limits.

The analytical approach treats a cluster as an empirically proven phenomenon, i.e. the geographical accumulation of companies from a value chain or sector and other associated players; the assumption usually is that a network exists between the players. The strategic approach comes from the fields of economic development, regional development and increasingly also structural and cohesion policy and is also covered by the term *competence field policy*. A vague conceptual distinction can therefore be drawn between the two terms as below, although this definition is not universally applicable. The competence field concept as employed by politicians focuses on supporting emerging sectors. In this context, the term cluster describes the phenomenon to be empirically proven, i.e. geographical accumulation, and the term competence field policy the strategic development of emerging sectors. The competence field concept is designed to ensure the positive development and sustainability of existing value chains. Sectors or industries not seen as potentially major forces behind job creation or innovation may well be clusters in the analytical sense provided the companies are geographically concentrated; however in this case one would not use the expression competence fields (see also Gärtner 2004).

Clusters in analytical terms have long been used in spatial economics (see for example "the system of growth poles" by Lasuen, 1973). The term in its current use as a popular approach comes from *PORTER'S* (1993) concept of *The Competitive Advantage of Nations*.

PORTER defines clusters as "geographic concentrations of interconnected companies, specialised suppliers, service providers, firms in related industries, and associated institutions (e.g. universities, standards agencies, trade associations) in a particular field that compete but also cooperate" (Porter 1999b: 207f), including upstream and downstream companies both along and across the value chain. He thus uses the cluster concept primarily analytically.

PORTER assumes that the international availability of capital, goods, information and technology plays an important part in locations' structure. In his comparative national studies, he highlights the importance to regional development of what are mostly export-oriented clusters (Porter 1999a: 51ff.).

PORTER believes the key competitive advantages in a global economy "lie increasingly in local things – knowledge, skills, relationships and motivation that distant rivals cannot match" (Porter 1999a: 51ff.). This indicates a change in the relative importance of individual location factors: in the past, factors such as natural harbours or raw materials were important, but competition and competitive advantages today are far more complex. Interaction between players on the ground now takes the form of non-material rather than material linkage.

PORTER'S clear focus is on companies. He recommends, for example, paying more attention to "efficient infrastructure, sophisticated suppliers and other cluster benefits" when deciding on location, in other words to the overall system costs and potential for innovation, rather than concentrating on low wage costs and taxes (Porter 1999a: 61).

REHFELD sees the cluster approach first and foremost from the perspective of economic development or regional structural policy. He bases his approach on the finding that economic structural change's effects differ widely from region to region, and even companies operating on international markets cannot completely escape the ties binding them to their location (Rehfeld 1999). Similarly to PORTER, he considers proximity[7] to companies and institutions in a production chain as vitally important if the challenges of global competition are to be met.

REHFELD uses the term cluster to refer to all spatially concentrated elements in a production chain whose end products are destined for interregional trade and which thus promote regional specialisation (Rehfeld 1999: 43ff).

In this approach, regions with interfaces between internal and external economic networks benefit the most (ibid.). The fact that REHFELD's definition of competitive clusters focuses on products for the foreign or interregional market does not mean he considers sectors concentrating on the local market as unimportant to a city or region's development. He believes that although clusters act as an economic stimulus in regional development, the economic development of a region depends on a complex combination of factors and cannot be reduced to the existence of individual clusters. Aspects such as quality of life, competence in economic development and pioneering infrastructures are also essential (Müller et al. 2002: 9).

7 Proximity need not necessarily be geographic; the term can also refer to social connection.

There is a wide range of other approaches and concepts which have certain aspects in common with the basic principle of the cluster. *Local economic concepts* for example are increasingly popular in urban renewal schemes. Such approaches try to overcome the economic discrepancies between weak and wealthy districts within cities and include various elements of the competence-based approaches. Their clear focus is, however, on equalisation.

1.2. Trends in Spatial Economic Theory

As already outlined, this study defines spatial economics according to three traditional, theoretical trends. These are set out in the following pages (Chap. 1.2.1 – 1.2.3) and will be discussed in terms of growth, regional competitiveness and equalisation. Chapter 1.2.4 will then present the concept of endogenous regional development. Albeit not a classic spatial economic concept, this is an alternative approach which has influenced regional structural policy since the 1970s.

1.2.1. Supply-Oriented Theory: from Neoclassical to New Growth Theory

The neoclassical growth model assumes that disparities between regions are short-lived. The move of production factors to the place offering the best wages levels out pay differences and brings individual areas of the national or global economy to the same level of prosperity. This is a closed theory and, while the models it uses can explain regional and growth processes, it is based on unrealistic assumptions such as the rationality of households and companies, price transparency, perfect competition, an absence of transport or transaction costs, the unlimited mobility of factors of production and the exogenous determination of progress. What is more, neoclassical theory considers neither demand nor the varying, region-specific effect of agglomeration (Arndt 1978: 34ff.).

The New Growth Theory, based on neoclassical equilibrium theory, attempts to be more realistic in its assumptions as empirically proven regional divergence sparked criticism of the neoclassical model. The main difference to neoclassical theory is that it allows for varying spatial developments based on endogenous factors, in particular the benefits of agglomeration. "One of the fundamental assumptions when endogenising growth is the existence of positive external effects. In the models provided by New Growth Theory, these generally take the form of knowledge spillover between companies" (Dybe 2003: 103).

New Growth Theory covers a broad range of different models. One widely used is KRUGMAN'S New Economic Geography (NEG) Centre/Periphery Model. He developed it the 1990s and employs it to explain the spatial concentration of economic activities as an endogenous process. According to this model, agglomerations can be attributed "to 'cumulative processes' and circular causation" (Roos 2003: 108) rather than inherent differences in the location. KRUGMAN's model assumes among other things the existence of (knowledge-based) spillovers producing increasing scale effects, the existence of transport costs and the partial immobility of sections of the population. He used these models to examine when, working on these assumptions, concentration processes would occur at business locations in a particular area. Increasing scale effects apparently accelerate concentration while the immobility of the population and high transport costs inhibit the process. They key question is thus the extent to which agglomeration effects, transport costs and factor mobility are centrifugal or centripetal (Fujita et al. 1999: 345). "The tension between these centrifugal and centripetal forces shapes the evolution of the economy's spatial structure" (ibid). The reduction in transport costs established in reality and the increase in the mobility of the production factor work results in centripetal forces dominating in the *Krugman Model*. Decreasing transport costs make it worthwhile to focus production at one site, in other words accept a greater transport distance, in order to achieve scale effects.

FUJITA et al. conclude that the current NEG models could explain many spatial phenomena but that there is a lack of empirical investigations to confirm them. They thus do not consider NEG as an approach which could justify interventionist measures, but take it rather as an analytical concept (1999: 348ff.).

NEG – similarly to polarisation theory (see Chap. 1.2.3) – basically assumes *circular causation*; its models can explain spatial effects but not their actual root cause which the model represents as historic and coincidental.

1.2.2. Demand-Oriented Growth Theories

Keynesian growth theories, like neoclassical theories, explain regional development in overall economic terms as exogenous, claiming regional development ultimately always tends towards equalisation (Hahne/von Stackelberg 1994: 48). Unlike in the neoclassical approach, however, they focus on demand-side factors which determine the use of supply factors and capacity. The investments this brings generate income, attract further investment in production plants and thus increase real capital and demand for back- and forward linkages.

Keynesian theory, in particular economic base theory, has now found its way into spatial economic theory which sees a region's export of goods and services as the driving force behind economic development. Proponents of this theory assume a region's economic activity can best be stimulated by increasing export demand, a so-called basic activity.

In the *single region model* of economic base theory, income generated by export is attributed to the multiplier effect. On the one hand, revenue from export creates domestic demand; on the other, so the theory assumes, part of the export revenue is used for further expansion of the export infrastructure (production capacity). The multiplier effect of regional exports may well be greater the higher the region's consumption and the lower its imports, however the decisive determining factor and thus the strategic key to a region's economic growth is, according to this theory, regional exports (e.g. Schätzl 2001: 153, Hahne/von Stackelberg 1994: 39).[8]

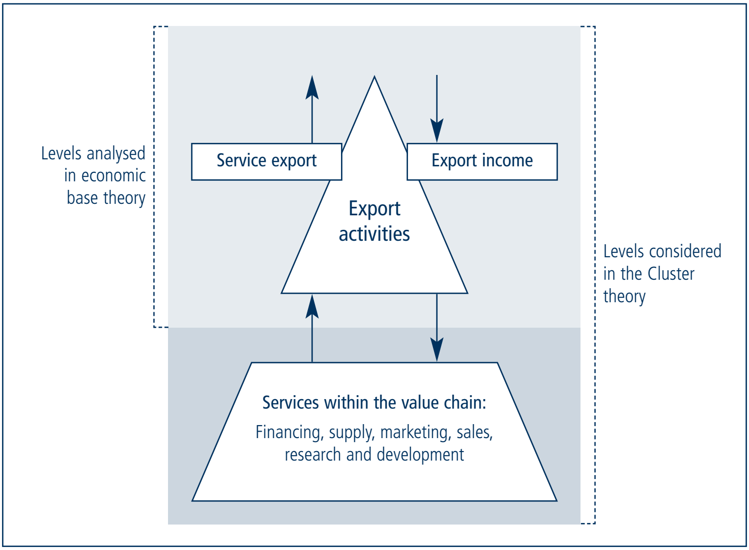
Economic base theory had a not insignificant influence on structural policy in Germany in the past. The *Gemeinschaftsaufgabe zur Verbesserung der regionalen Wirtschaftsstruktur* [Improvement of regional economic structures] launched in 1969 to coordinate federal and state government structural policy includes aspects of economic base theory, supporting companies in structurally weak regions with a focus on interregional and national sales (Becher/Rehfeld 1987).

8 Various alternatives to economic base theory were proposed in the 1970s which do not rely on increase in export as the key to increasing regional income. They attempt to substitute imports with regional supply in order to increase the multiplier effect of export revenue. These aspects are examined in Chapter 1.2.4.

Yet the very simplicity of this theory which fails to take account of regional aspects such as intraregional demand, networks, knowledge spillover and much more also means that it has many shortcomings. One such shortcoming from an overall economic perspective is that each export from one region implies an import into another. Growth processes in a city thus involve a kind of urban Darwinism (Läpple 1998b: 199) as this leads to backwash effects in other regions and, at least in theory, a national economic zero sum.[9]

Economic base theory has some basic similarities to the competence field or cluster approach: both focus mainly on export-oriented sectors. As shown in the diagram below, there is however one significant difference. The focus in economic base theory is solely on export-oriented companies while the cluster concept considers the entire value chain and its interrelations at the location in question.

Figure 4: The concept of the region between economic base theory and the cluster concept



9 It should be noted that when several regions expand their export-oriented basic activities and simultaneously also increase their imports, specialisation and agglomeration effects as well as comparative cost benefits mean it is perfectly possible that prosperity in all regions increase; however the theory does not consider this.

1.2.3. From Polarisation Theory to the Growth Pole Concept

In the growth theories addressed above, regional development – a result of exogenous general economic conditions – leads to an equilibrium between regions.

The polarisation theories presented below which developed in the late 1950s take an opposite stance and attempt to explain the differences in economic development from region to region.

Polarisation theories are based on a range of assumptions in stark opposition to those used in equilibrium theories (e.g. Schätzl 2001, Hahne/von Stackelberg 1994):

- growth determinants from original production factors to what are now more important factors such as knowledge, innovation potential, competences and networks are unevenly distributed among the regions;
- factors of production are partially immobile;
- interregional dependence and the local situation are important to economic development, one example is the interdependence of centres and peripheries;
- markets are imperfect and their structures oligopolistic or monopolistic. Innovations create temporary monopolies.

The sectoral polarisation theory taken up by PERROUX[10] in the mid-20th century was first proposed by SCHUMPETER (1987, first published 1934). In his book *Theorie der wirtschaftlichen Entwicklung* [Theory of Economic Development], published in 1934, SCHUMPETER had claimed that basic innovations such as the steam engine were responsible for the wave-like development of the economy (also known as long waves). He believed these basic innovations spark a series of *secondary and tertiary innovations* and this sets off a wave of developments. Innovations generate investments in the sectors concerned and produce *accelerator and multiplier effects*[11] which lead to a process of growth and development.[12]

10 Perroux, F., 1964: L’économie du XXème siécle. Paris. In Schätzl (2001).

11 These are terms used to describe the effects of consumption funded by income, company investments and public spending which grow and multiply.

12 An inherent feature of innovations is that other technologies and infrastructures are no longer needed. “In this way, not only outdated material capital stock is destroyed but usually also the jobs which depend upon it, (…) the socio-economic and the spatial structures” (Hahne/von Stackelberg 1994: 49).

PERROUX adopted this basic concept when he described the industries created in the innovation process as sectoral growth poles. He assumed that linkages turn these poles into driving forces, making them highly competitive and able to stimulate other areas of the economy.

MYRDAL (1969) re-examined sectoral polarisation theory, placed growth poles in a spatial context, discussed their effects on the region and thus created *regional polarisation theory*. He is critical of neoclassical theories and assumes the spatial distribution of these poles to be unequal, an inequality which will cumulatively increase in the absence of intervention.

He counters the hypothesis of even development across regions with the concept of circular causation in a cumulative development process (Schätzl 2001: 161). The indivisibility of internal and external savings strengthens coincidental stimuli for or obstacles to growth, and inter-sector linkages spread stimuli to other sectors in the region. The process of positive feedback is balanced against *backwash effects* on weak areas.

The centres absorb a proportion of the mobile production factors at the expense of the periphery or old industrial areas.

Supposedly better living and working conditions in the centres attract well-qualified young people in particular and this intensifies the spatial effects of this economic phenomenon. This is compounded by falling State revenue as demand from the public authorities as customer is necessarily low and there is a continuing lack of public investment in the regional infrastructure.

Positive effects in the successful regions are concentrated in the area and therefore cumulatively increase but they do begin to diffuse into the surrounding region once a certain level of concentration has been reached. The process described by MYRDAL as a counter-effect to backwash leads to the spatial spread of investment. MYRDAL assumes that the backwash effect will always outweigh the spread effect. “In no circumstances, however, do the spread effects establish the assumptions for an equilibrium analysis. In the marginal case, the two kinds of effects will balance each other and a region will be stagnating” (Myrdal 1969: 32).

The overall assumption is that spread effects will be stronger the more developed the national economy because infrastructures are more advanced and the problems of agglomeration intensify deurbanisation (Hahne/von Stackelberg 1994: 51).[13]

"Not much has been made of the financial aspects of cumulative theory, except to argue that financial institutions share in the dynamic economies of scale which characterise business in the centre (…). This argument would suggest lower borrowing costs in the centre, but this reinforcement of regional disparity is not made use of in cumulative causation theory" (Chick/Dow 1988: 229). Banking systems are not the focus of polarisation theory (Dybe 2003: 95ff.), but MYRDAL nevertheless points out that flows of capital tend to "increase inequalities. (…) Different studies in many different countries have shown how the banking system tends to remove savings from poorer regions and invest them in richer and more advanced areas offering high and guaranteed profits unless intervention forces it to act otherwise" (Myrdal 1959: 26). In the theory of circular causation, banks are therefore both a cause and effect of the concentration of economic activity: a cause because companies seek geographical proximity to banks for capital procurement reasons; an "effect because, from the banks' perspective, customer proximity above all to the increasing number of major companies in the centres is an important location factor" (Dybe 2003: 94).

Whether in reality centrifugal forces outweigh the centripetal or vice versa, i.e. whether spatial disparities in income decrease or increase, depends on a number of conditions on the ground. The answer cannot be clearly, empirically established and varies according to the political view. Alongside socio-political and constitutional objectives for balanced regional development, policy in the past was also aimed at promoting spread effects to make full use of growth potential (e.g. Schätzl: 164).

Polarisation theories too are not closed; the term covers a large number of relatively loose partial theories which explain complex circumstances without offering a conceptual key to regional development. Polarisation theory has for this very reason been developed further in other approaches such as the growth pole concept.

13 A good transport infrastructure may however also lead to more rapid backwash effects (Genosko 1997: 109).

The growth pole concept is a development concept harnessing both the cumulative effect of the spatial concentration of economic activities and the regional spread effect of investments. It proposes that regions be systematically supported by the spatial concentration of investments in areas which are structurally weak. Advocates of this approach assume that growth stimuli spread from the growth poles to more peripheral locations in a hierarchical process, but do consider both concentration and backwash effects. Many approaches have taken the regional growth pole concept as the basis for structural policy measures.

The growth pole concept has certain basic similarities to the cluster approach: both focus on the spatial concentration of economic activities. The cluster approach, however, uses functional differentiation as well as concentration to create specific benefits such as knowledge spillover, and that is not the only difference. The growth pole concept has been used above all in the development of weaker areas where the aim was to produce so-called spread effects. In the cluster approach, spread or spatial distribution is actually counter-productive as it risks reducing concentration below the necessary critical mass.

One example which demonstrates the fundamental similarities between the growth pole and cluster concepts is the *system of spatial growth poles* developed by LASUEN in the 1970s. LASUEN defines a growth pole as a cluster of businesses in one region and sector linked by regional export activity (Lasuen 1973). He bases his approach on the growth pole concept but combines it with other theories: "it seems necessary to relate the framework of growth pole theory with those of central place theory and industrial structure analysis (…)" (Lasuen 1973: 164).

1.2.4. Endogenous Regional Development

Critics of growth-oriented development approaches believe that these methods' exclusive focus on export activities, as for example in economic base theory, and concentration on industrial products neglect *endogenous potential* and lead to a constant regional disequilibrium. "With the growth centre doctrine as its principal tool, spatial development planning became the handmaiden of transnational capital" (Friedmann/Weaver 1979: 186).

Decentralised endogenous development has been advocated as an alternative model since the 1970s. Support for this alternative grew as a result of the economic slowdown and expected rises in transport costs following the 1973/74 oil crisis as well as greater public awareness of environmental damage, triggered for example by the *Report to the Club of Rome* (Meadows 1972). Structural policy was also criticised for the limited success of location incentives and resulting reinforcement of spatial disadvantages.

The concept of endogenous regional development, although primarily conceived as a development strategy for developing countries, was also designed for use in the peripheral regions of industrialised countries.

HAHNE'S concept of *intraregional potential* covers the issues addressed by a large number of similar approaches. It works on the assumption that the spatial functional division of roles uses only certain specific skills and potential for which there is nationwide demand whilst allowing others to disappear. Resources such as segments of the labour market, manual skills, traditions and cultural and ecological potential are thus used neither efficiently nor innovatively (Hahne/von Stackelberg 1994: 79ff, Hahne 1985).

Certain similarities to the cluster approach can be seen in the focus on endogenous development potential. A key question here is whether all regions have sufficient potential to launch their own development, and whether structural policy aimed at equalisation can rely on this potential alone. Unlike the cluster approach, this concept assumes that all regions have the ability to develop equally and independently and therefore does not call for concentration or specialisation. The qualitative improvement of regional living conditions, not economic growth, is at the centre of this approach.

1.3. Banks and Regions

The introduction raised the point that issues of spatial economy are seldom addressed in banking theory or vice versa. Those who have worked on this question include CHICK and DOW, whose article "A post-Keynesian perspective on the relation between banking and regional development", published in 1988, is still referred to in current literature. They suspect that literature on spatial economics sees financial and banking systems as irrelevant because the same currency is used within individual countries (1988: 219). Spatial assessments of banking markets in economic analyses are therefore usually limited to a national level; the scale of market structures, i.e. the number of banks in a market, is usually only compared on a country to country basis. This is due not only to the absence of an empirical basis for a more detailed spatial assessment, but also to the view of many economists for whom – currency differences apart – banking markets generally operate in a spatial vacuum.

Financial geographic analyses address specific areas such as investment or venture capitalists and their spatial distribution (Klagge/Martin 2005) or the location of specialised international financial hubs i.e. the concentration of financial institutions in one particular place. These financial centres act as international powerhouses (e.g. Sassen 2002, Porteous 1999) and usually provide financial services for the global market. Few studies, however, address the role played by banks and regional flows of capital in the overall development of regional economies (Martin 1999: 5).

As the regional availability of credit depends on the local presence of financial intermediaries and credit is vital to regions' development (Chick/Dow 1988: 220), an assessment of banking systems, structures and theories in the context of regional development has a central role in this study.

The focus on decentralised banking systems appears to contradict the situation outlined above, but this contradiction can be explained. If, as more recent regional economic approaches and theories claim, the spatial cumulation of sectors and value chains is advantageous, why should this not apply to banking? Why, indeed, should policy be aimed at ensuring the equal distribution of financial intermediaries across the regions: transport costs in the financial sector, which trades in intangible products, are of little significance.

In view of the findings presented in Chapter 1.1, should not equal spatial distribution be rejected on the grounds of efficiency? Yes and no. Yes, if the segment in question is international financial services which can be provided more efficiently at specialised locations. No, if it is a question of ensuring access to credit for SMEs, in other words the *provision of essential banking services*, for this requires local financial intermediaries who are able to gather information on their customers and customers' markets.[14] Regional banking systems create a link between the local economy and the global financial centres which deal with business such as international transactions.

Chapter 1.3.1 assesses the functions of financial intermediaries. Chapter 1.3.2 discusses banking theory approaches and Chapter 1.3.3 then looks at banks in terms of spatial and regional economics. The Chapter ends with an assessment of the role of social capital in the banking industry (Chap. 1.3.4).

1.3.1. The Function of Financial Intermediaries

Financial markets broker capital between investors and have certain specific features which distinguish them from other markets. Literature on the subject (e.g. DBB 2005c, Klagge/Martin 2005, Fischer/Pfeil 2004, Engerer/Schrooten 2004) has established:

- firstly, that information is distributed asynchronously between savers and investors and that available information is incomplete;
- secondly, that the sector's business is lending, i.e. credit, interest and repayments are inter-temporal, and
- thirdly, that the lending business is based on trust that the sum will be repaid.

14 The problem of differentiating between highly specialised value chains which benefit from concentration and public services which should ideally be available everywhere is a recurring one in regional and local economic development policy. A good example of this is the health sector, which is the focus of cluster activities in many cities and regions. As complete basic care is needed, this sector has a broad spatial distribution. This should mean the health sector is in fact not suitable for clusters, but this does not apply to the sector as whole. Medical technology, pharmacy and biotechnology, for example, are all spatially concentrated (Rehfeld 2006: 74ff.).

Savers who placed their money directly with investors without the assistance of financial intermediaries would, so literature in the field claims, lack information and be unable to process or check information as well as financial intermediaries. Problems would also arise due to varying terms, and low diversification would lead to high risks. Ultimately, financial intermediaries' role is to ensure the diversification of risk, balance differing terms and gather and assess information.

Functioning banking and financial systems provide a highly efficient capital allocation mechanism and thus contribute to higher investment productivity and to national economic growth (DBB 2005c: 104). The finance business is therefore vital and its strength or weakness affects other sectors of the national economy.

A distinction is drawn between bank-based and capital market-based financial systems in the provision of finance. The former term refers to outside company financing through loans; an example of the latter would be venture or risk capital.[15] Even if capital-market based financing is on the increase (*Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung* [German Council of Economic Experts] 2005: 455), Germany's system is still clearly bank-based (Hackethal/Schmidt 2005).[16] This is the product of a whole range of what are in some cases cumulative factors such as the SME-dominated economic structure, the corporate mentality and the easy access to attractive bank loans over recent decades – this last meant it was not necessary to reinvest profits in order to increase equity (Nitschke/Schoder 2005). A successfully functioning banking system in Germany is in this respect of great importance to both regional and national economic development.

1.3.2. Banking Theory

In view of the enormous importance of bank-based financing in Germany, the following pages will look exclusively at banking theory and the relation between customers and banks (relationship lending).

15 It should be noted that the various different forms of financing are interrelated. Those seeking loan financing under attractive conditions need a good equity position, which can in turn be improved using venture capital (Klagge 2003: 179).

16 Some authors point out that developments on the financial markets, increasing globalisation and, in particular, changes in regulation (e.g. Basel II and new accounting regulations) have increased and will continue to increase the importance of capital market financing compared to loan financing (e.g. Klagge 2003: 182).

In the past, the principles of traditional economics were also applied to banking theory. Banking systems were considered efficient if concentration in the sector was low, i.e. competition was intense (Martin 1999: 10ff.). A high number of service providers – so the theory ran – prevents monopoly or oligopoly profits and thus ensures low prices. "This is exactly why indices of market concentration (…) play such an important role in almost all recent assessments of US and European banking markets. They are widely used in empirical work" (Fischer/ Pfeil 2004: 308). There has for this very reason been a global move to reduce anticompetitive regulations on the banking market ever since the 1990s. "Many economists now consider competitive privileges to be more or less unjustifiable" (Fischer 2005: 2).

Yet weaknesses are now appearing in classic banking theory in terms of allocation efficiency, the availability of credit and the stability of financial systems. Some recent studies note that "perfect competition does not necessarily produce the best results for the national economy as a whole. In some areas of their business at least, banks appear to be operating on less than ideal markets" (DBB 2005c: 107).

New banking theory therefore takes more account of the peculiarities of the financial markets and does not necessarily consider maximum bank competition as the optimum. Its main principles can be roughly summarised as follows: it is based around the asynchronous distribution of information between debtors and creditors and the assumption that information can be used more than once. Banks gather information on borrowers and can refer back to this information repeatedly in the course of a long-term relationship with a customer. This knowledge, known as information capital, is a major part of the banks' assets; it is the "commodity" with which they work (Bodin 2001: 2). However, information obtained about a borrower can be reused not only by the banks which extended the initial loan, but also by their competitors. This transient commodity is therefore particularly hard to protect on highly competitive markets. If a bank invests in borrower-specific information as part of a credit check, there is a risk that competitors note the results of the check but at a significantly lower cost and are thus able to offer better terms of credit (Fischer 2005: 101).

In theory, this *free rider problem* means there is a lack of investment in information procurement on highly competitive markets and this can lead to credit rationing. The theory of credit rationing states that the asymmetrical distribution of information means not all demand for credit can be met. If complete information were available, the interest rate would alter accordingly so that each borrower received a loan at a rate appropriate to the risk involved (*Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung* 2004: 286). This applies in particular to loan financing for small and medium-sized enterprises (SME) and start-up financing, in which little information is available (as yet) and the average loan volume is lower. Lower volume also means that these loan commitments are less profitable in terms of the economics of scale.

In markets with less intense competition, on the other hand, long-term customer-bank relationships can be created and this has a positive effect on the availability of credit. "The argument is based on an inter-temporal smoothing effect. In later periods and by virtue of their market power, banks are able to extract a larger part of the project surplus from the good customers who survive." (Fischer/Pfeil 2004: 335). This phenomenon is known as *relationship lending*.

The simple sum which equates greater competition with lower oligopoly profits and states that intense competition is thus always the best option for cost-effective and comprehensive supply would thus not appear entirely applicable to the banking markets. From a theoretical perspective, it would also appear that less competition leads to stable relationships between customers and banks, reducing risks and transaction costs and making it worthwhile to lend companies smaller sums.

1.3.3. Banks and Regional Development

Countries are usually taken as the analytical basis in literature on finance and banking theory while geographical area within a country is largely ignored. According to KLAGGE/MARTIN (2005) and CHICK/DOW (1988), financial and banking systems can be considered either as space-neutral or non-neutral, as shown in the diagram below.

Figure 5: Banking systems and space

Classic economic theories ▼	Demand-oriented theories, polarisation theory etc. ▼
Optimal banking and financial markets 1. Banking markets are no different to other markets. 2. Competition organises the market and leads to maximum efficiency. 3. Information is available, time and area are irrelevant.	Non-optimal banking and financial markets 1. Banking markets operate in their own specific way. 2. Transaction costs, in particular in the form of credit check costs, play an important role in lending. 3. The payout and repayment of loans are not simultaneous and information is asymmetrically distributed.
Neutral banking systems ▼	Non-neutral banking systems ▼
Spatial structure 1. Distribution of financial intermediaries is unimportant. 2. Proximity is unimportant. 3. Access to credit is guaranteed at every place, even for small and medium-sized businesses 4. Capital moves to the place offering the best returns. Production factors move and this leads to balanced regional development.	Spatial structure 1. The spatial distribution of financial intermediaries has an important role. 2. Proximity is vital for both the borrowers and the banks. 3. A shortage of credit blocks regional development 4. Cumulative effects can be generated.

Source: author's own diagram based on Klagge/Martin 2005: 391[17]

CHICK and DOW (1988: 221ff.) refer to two theoretical approaches in their more detailed definition. The first, drawing on post-Keynesian theory (see 1.2.2), dependency theory[18] and polarisation theory (see 1.2.3), is that banks play a central part in a region's development. The opposing view they present is based on neoclassical theory.

17 Klagge and Martin, however, apply this to financial markets and less to bank-based systems.

18 Dependency theory combines a number of theories discussed primarily for Latin American countries which put variations in development down to interdependence major between industrial cities and the periphery. These theories state that regions have no chance of revitalising their economies unless this dependency ceases and they develop independently (e.g. Palma 1981).

According to the “neutral” view advanced by neoclassical theory, banking systems are most efficient when there is maximum capital mobility and intense competition. As geographical space is from this perspective unimportant, each profitable investment will be funded irrespective of place (e.g. Martin 1999: 10ff., Klagge/Martin 2005: 391ff.). “Financial institutions intermediate between savers and investors, and funds systematically flow to those projects with the highest perceived rate of return, wherever they may be” (Chick/Dow 1988: 223). Theoretically, high profitability generates a temporary increase in the flow of capital to booming regions which however eventually slows again: after a certain point, returns in the boom regions drop due to a growing supply of capital.

Both the new banking theories (e.g. Fischer 2005) and various spatial economic theories indicate that banking systems affect and are affected by geographical area (e.g. Klagge/Martin 2005: 392ff., Fischer 2005, Dow 1999: 48, Chick/Dow 1988). If one works on the assumption that the banking system is not space-neutral, the key to lending for SMEs is proximity. Smaller businesses need an efficient banking environment close at hand, and proximity to their borrowers is also vital to banks which lend to SMEs. “Close long-term relationships between companies and their main bank reduce the information asymmetry between debtors and creditors which is particularly extreme in the case of SMEs. They provide the foundation for a trusting partnership and this benefits both parties (...). This explains why SMEs in Germany, where the system of local banks continues to play a major role, concentrate not only all their loans but indeed often all their business with one bank.” (Neuberger/Räthke 2001: 15). Regional banks’ personal contacts give them comparative cost benefits, in particular when lending to customers with a short credit history (founders) and companies which do not publish their profit figures (*Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung* 2004: 287).

The debate on whether banking markets are important to regional development raises a further question, namely whether knowledge is available everywhere or only in specific geographical areas. Distance from the potential customer according to the *spatial relevance* argument determines the amount of information banks hold on borrowers. This knowledge-based differentiation of regional markets is in clear opposition to the neoclassical view that knowledge, at least within a country, is available everywhere and to the same standard.

Structurally weak peripheral regions would be particularly badly affected by a poor regional credit supply: a lack of credit prevents companies from developing and this cumulative process can make these regions even less attractive to banks. Some authors (e.g. Klagge/Martin 2005: 395, Chick/Dow 1988: 221, Dybe 2003: 94) refer in this context to Myrdal's principle of circular causation (see Chap. 1.2.3) and conclude that "this may perpetuate a cumulative process in which less credit means lower growth in the periphery; this in turn depresses credit demand there in the future" (Klagge/Martin 2005: 395). A cumulative process can be mapped not just for the regions, for the reverse also applies to the centres. The cumulation of companies i.e. potential borrowers, better potential returns and a more stable economic structure mean – so it is assumed – that the centres are a more interesting location for banks than the periphery (Porteous 1999). CHICK and DOW (1988: 239) believe that the concentration of financial institutions in the centres tends to lead companies reliant on loan financing to set up business there, or that such companies are able to grow more rapidly in the centres as the banks have better and cheaper access to information (e.g. Dybe 2003: 95, Chick/Dow 1988, Myrdal 1959). Added to this are rising scale effects and spillover caused by the cumulation of financial institutions (Klagge/Martin 2005: 395). Banks can therefore be deemed to have a catalytic effect on the development of centres. DYBE concludes that "banks are not the cause of economic inequalities but, were it not for banks, low interregional capital mobility would mean a less extreme divide between centre and periphery" (2003: 95).

Banking markets in the past were subject to numerous regulations to avoid this very risk of capital outflow from weak peripheral regions and ensure weaker regions a supply of credit; financial institutions were also created in regions with little access to credit (see for example Myrdal 1959: 42). The long regional division of the US banking market, for example, was due not only to large distances between the centres and the lack of communication technologies on the scale now available, but also to a range of legal regulations which placed regional limits on the banking markets. It was only in the 1970s that the progressive liberalisation of US banking markets began (Martin 1999: 7ff, Reifner et al. 1998, Chick/Dow 1988: 240). Regulations obliging decentralised cooperative banks and savings banks to limit business activities to one region applied in many European countries too until just a few years ago, and these regulations were also aimed at restricting regional capital outflow.

At a global level, however, international institutions (e.g. the International Monetary Fund/IMF, the World Trade Organisation/WTO), countries and indeed also the EU (see Chap. 4.1) advocate deregulation, privatisation and open banking markets as a way to – they believe – increase efficiency and thus also improve general welfare (Budd 1999: 118f, Martin 1999: 10ff.). This is reflected in the *Financial Service Agreement* concluded in 1997 as part of the General Agreement on Trade in Services (GATS), in which 25 industrialised nations and 77 developing countries committed to far-reaching liberalisation (WEED 2006: 1f.).

The German banking market is also liberalised to the extent that there are no restrictions on market access for competitors. Private, cooperative and public banks; regional, national and foreign banks all operate on the market in Germany. However, the savings banks or *Sparkassen* and, in a similar way, the cooperative banks form an exception here as they are still subject to regional restrictions on lending (see Chap. 3.1). Capital outflow from weaker regions in Germany is thus checked by these banks without the banking market being regulated and controlled. These public regional banks put Germany in a unique position.

1.3.4. Banks and Social Capital

Knowledge of values, culture, symbols and attitude in a regional context; trust and geographical proximity; local connections and loyalty etc. are vital if local banks are to benefit regional development and indeed succeed as regional banks. Nevertheless, the factors termed here as social capital[19] (e.g. Cooke et al. 2005, Camagni 2003, Krätke 2001) are only very gradually entering financial and banking theory despite their particular importance for credit markets: credere (Lat.) means trust (Martin 1999: 11).

The fact that social capital is also or indeed particularly important in an economic context has long been recognised and is by no means limited to the banking sector. Overall, an increasing divergence is emerging between an acceptance of the importance of social capital as a whole to economic development and a country's welfare, and the standardisation and harmonisation of processes, lifestyles and cultures (e.g. Grote Westrick/Rehfeld 2006).

19 Cooke et al. (2005: 1066) define "social capital as the application or exercise for social norms of reciprocity, trust and exchange for political or economic purposes".

This is reflected in the EU's attacks on Germany's services of general interest, which it sees as anti-competitive (see Chap. 4.1), and also in the desire to stabilise financial systems with more detailed, internationally applicable, harmonised regulations governing the investment of equity capital (Basel I and II) (Gärtner 2003: 50ff.). The chairman of the *Nordrhein-Westfälischer Handwerkstag* [North Rhine-Westphalia Trade Council] notes that "There was a time when close ties to a specific bank and personal contact with the customer advisor, often of many years' standing, meant that so-called 'soft factors' were considered in risk assessments for loans. Basel II now focuses above all on the 'hard' risk indicators" (Köster 2005: 11). This is compounded by the fact that many banks use an IT scoring system[20] to process large numbers of standardised loans rapidly and cost-effectively. Scoring in the banking industry is a system in which points are allocated to various aspects (e.g. profession, housing situation) affecting a borrower's credit rating. These systems either help the customer advisor reach a decision or are applied on their own, using an automatic credit check to decide whether or not the applicant should be granted a loan and under what terms and conditions (Hottenrott 2002: 194ff.). It is currently unclear how far the automated gathering and evaluation of credit rating information and increasing harmonisation of regulatory agreements will reduce information asymmetry, lead regionally-oriented banks to focus more on standardised indicators, open up the capital markets for SMEs and thus actually make banking systems less spatially dependent. The regional development benefits of close customer-bank relationships could be lost in this process.

Replacing regional banks and traditional main bank relationships could offer advantages on efficiency grounds, as KRAHNEN explains. "One reason for further reducing the role of intermediaries is the presumably positive returns to scale which would be possible using centralised credit checks by rating agencies instead of credit checks by several banks. Moreover, loans negotiated on the market enable better risk allocation whilst daily valuation offers the prospect of high liquidity and rapid access to information" (Krahnen 1998: 9).

20 The most famous example in Germany is Norisbank's Easy Credit, offered among others by the Volks- und Raifeisenbanken. Loans in this scheme are granted or refused in a completely automated statistical process (Ritzer 28.08.2006).

Two questions therefore remain open: not only what effects the trends above will have on the stability of customer-bank relationships and consequently on the importance of regional banks, but also whether a standardised, space-neutral banking industry focussed on statistical scores would increase or decrease prosperity. Perhaps the financial crisis raging since 2008 will help answer this question.

1.4. Spatial Economic Theories, Intervention and the Role of Banks

The various schools of spatial economic theory can, it is true, be classified according to different phases, but they do not follow a one-dimensional chronology. The table below addresses four main structural and economic development policy approaches in the light of spatial models and effects and the role of (regional) banks. The four approaches presented here are based on ideal circumstances and would not appear in this form in reality, however they help explain various spatial models on which the various phases of structural policy were based.

Table 1: Spatial economic theories, effects and the role of banks

Theoretical approach to:			
Neo-classical theories ▼		Demand oriented theories ▼	Polarisation theories ▼
Strategic implications for intervention			
Equilibrium theories	Growth pole concept	Independent regional development - Alternative approaches - Complementary approaches	Competence-based approaches - Industrial Districts - Production Clusters - Innovative Milieus
Approach			
Theories and models (deductive approach) Empirical observations in New Growth Theory	Empirics (inductive approach) with theoretical basis	Empirics and conceptual schemes	Empirics and conceptual schemes.

Table 1: Spatial economic theories, effects and the role of banks

Theoretical approach to:	Neo-classical theories	Demand oriented theories	Polarisation theories
Equalisation mechanism			
Equalisation through market forces	Equalisation through redistribution	Equalisation through the activation of endogenous potential	Equalisation through growth and concentration (indirect)
Intervention			
Low intervention: only if the market fails. Infrastructural policy in accordance with New Growth Theory and export development following economic base theory.	Investments in infrastructure. Incentives for companies. Concentration on growth poles.	Promotion of intraregional cycles. Dealing with obstacles to development. Activation of regional potential. Intraregional income multiplier.	Promotion of networks, generation of knowledge and information, specific infrastructures and specific sectors.
Spatial thinking			
Regions ultimately tend towards an equilibrium. According to New Growth Theory, locations specialise and agglomeration effects lead to spatial concentration.	Aim: equal distribution of economic resources; investments to be concentrated on decentralised growth poles.	Equal distribution of low level economic activities. "Self-sufficiency" and ready availability of essential economic functions in all areas.	Certain level of concentration & spatial specialisation. Agglomeration benefits, knowledge spillover and increasing scale effects create competitive advantages in some regions.
Conclusion			
Little basis for a structural policy aimed at equalisation.	High financial input without long-term effect (deadweight effect) due to regional path dependence. Current lack of (re)location potential.	Only limited use can be made of internal & external savings as no agglomeration forms. Systematic separation means no transfer of knowledge & know-how. Risk of lock-in.	Positive effects for development in some regions. Redistribution mechanisms & understanding different space thinking therefore needed. Coherence question: growth or equalisation. Risk of erroneous development forecasts.

Table 1: Spatial economic theories, effects and the role of banks

Theoretical approach to:	Neo-classical theories	Demand oriented theories		Polarisation theories
Role of banks				
	Banks act as intermediaries between savers and investors. Geographical location within a country is irrelevant.	Banks play important role as regional institutions.	Banks are so-called essential infrastructures and thus have a key role in regional development without intervention.	Banks play an important role as regional institutions.
Influence of regional banks with regional limits on flows of capital				
	Regional banks are insignificant as information is available everywhere and all promising investments are financed. Regional banks which restrict capital mobility are counter-productive.	Positive concentration processes limited by regional circular flows of income. However, as the long-term objective is expansion, regional banks prepare the way for balanced development.	As regional banks' development is linked to the regional economy, they could be weaker in weak regions and this would increase the lock-in effect.	The importance of proximity applies to all institutions, in particular to banks. A distinction must be made between highly specialised services and essential banking services in the financial services sector. Regional banks take on a growth and equalisation role.

The first intervention strategies here are the equilibrium approaches based on supply and demand-oriented theories (see Chap. 1.2.1 and 1.2.2). Neoclassical equilibrium theories only allow for intervention in the case of market failure. New Growth Theories developed on the basis of these classic theories, for example NEG, explain spatial concentration and specialisation processes. State intervention according to these theories is justified if an increase in the efficiency of centres affects overall economic growth, as this can reinforce regional disparities. Intervention strategy thus in this case depends on the political question of how great a spatial inequality can be accepted for efficiency reasons. This is linked to a question of economic theory, namely whether free market forces tend to produce excessive agglomeration or lead to the insufficient concentration of business activity in allocative terms (Pflüger/Südekum 2004: 11).

Banks in neoclassical theory operate as intermediaries between savers and investors. Their geographical location is irrelevant as every profitable investment is financed regardless of place; indeed separate regional banking markets are considered counter-productive as they restrict capital mobility.

The growth pole concept is another theoretical approach to intervention and is based on regional polarisation theory (see Chap. 1.2.3), a model in opposition to classic equilibrium theory and models which attempts to explain the regional divergence which exists in reality. Growth poles in this approach are not equally distributed across countries or regions; they draw production factors away from the periphery but in some cases pass them back to the surrounding area. It cannot be clearly empirically determined whether in the long term the backwash outweigh the spread effects or vice versa. In an attempt to take advantage of the above effects, these basic principles were developed into a range of hierarchical spatial models. One such model is the focal point concept which proposes that investments, infrastructure and functions be concentrated on specific places so that a critical concentration can be reached and its effects spread to the surrounding area. In intervention policy terms, that means creating incentives for investment in focal points in weaker areas.

However, it has now become clear that areas develop individually or at least that it is difficult to refocus their development in the long term through investments or company (re)location; moreover, the region with its overall socio-economic reach plays a significant role and structural policy therefore cannot be reduced to investment incentives. Companies which have moved to an area give the location a sustainable boost if they become part of a functioning system from which they themselves draw lasting benefits. Another reason, at least officially, why these approaches are now rarely used is expense: high costs achieve relatively short-term benefits and there is also a danger of deadweight effects – this last is when companies would have moved to a location anyway but still avail themselves of the subsidies offered. A fall in the number of companies prepared to move into focal points has also rendered this approach less useful. Banks as an essential infrastructure are an important aspect of this approach: banks which operate solely in one region limit the backwash effect predicted by polarisation theory, but also reduce the concentration processes deliberately set in motion as part of the growth pole concept.

However, the fundamental aim of growth poles is to initiate long-term spread effects by concentrating investments in one place and thus eventually to benefit a larger area. Regionally segregated banks thus keep possible development routes open and prepare the way for spatial spread effects.

Concepts of independent regional development (Chap. 1.2.4) grew out of criticism of a policy focussed on growth. Similarly to economic base theory, these approaches are first and foremost demand-oriented but do also consider intraregional flows. They are aimed at activating endogenous potential in all regions; in practice they do not focus primarily on complete separation from the global market but are more concerned with increasing regional value creation by meeting as high a proportion as possible of regional demand. Political intervention is usually based on analyses of potential, the development of institutions – for example in the form of a local banking infrastructure –, support for small businesses, cooperatives, public infrastructures etc. The concept of endogenous regional development states that every region has a range of potential and dealing with certain obstacles to development can therefore balance out regional and national levels of prosperity.

The disadvantage of this concept could be that internal and external savings that are the result of a concentration of economic activities are not used to the full potential. Regions with less endogenous potential could, moreover, fall behind in the long-term. Banks with a local or regional focus are an integral part of such an approach, above all if they promote regional circular flows of income, but there is nevertheless a danger that separate banking markets intensify regional lock-in. If the banks in a weak region are also weak, fewer or smaller deposits mean fewer or smaller loans (see Chap. 5).

The competence-based approaches presented in the fourth column of Table 1 combine the various different ideas and concepts above by drawing on the one hand on regional competences and connections on the ground and on the other focussing on regional specialisation, in some cases also export-orientation.

These approaches are also aimed at developing regions by supporting endogenous potential; however the cluster approach at least is less concerned with supporting sectors which deal with regional demand. It concentrates more on regional specialisation and supporting export sectors competitive at an interregional level, yet as it considers the value chain in its entirety it also takes account of non-export-oriented companies. As in independent regional development approaches, the cluster approach uses regional analyses although in this case there is more focus on internationally competitive competences. Other tools include the promotion of networks, knowledge and information and specific infrastructures and business sectors. The innovative milieu approach focuses on socio-cultural aspects as well as economic factors and therefore uses a broader selection of tools; these can range for example from support for an ethnic community to promoting the art scene.

Unlike the growth pole concept in which companies moving to external hubs boost structurally weak regions, competence-based approaches aim to support the regions which already have national competitive potential. Competence-based approaches' objective is to use State aid to invest in those regions which are best equipped to become more competitive. It is still unclear whether or not the effects then spread to other regions and indeed spread is not the aim of this policy as the necessary critical mass in one place would be lost. It would appear that these approaches disadvantage weaker regions, at least temporarily, and that they would not produce the same effect in all regions. An important distinction must first be drawn before the above concepts can be discussed in relation to banks. If the banks in question are financial institutions providing highly specialised financial services, and if their work is allocated at an international level, then spatial concentration should be encouraged. However, banks which offer essential banking services are an integral part of local areas and area infrastructure. Banks bound to a region are extremely familiar with the local economic structure and can thus recognise and help develop promising economic competences. As they offer essential banking services in all regions and reduce regional financial backwash, such banks also limit one problem with competence-based approaches, namely that they indirectly increase regional disparities.

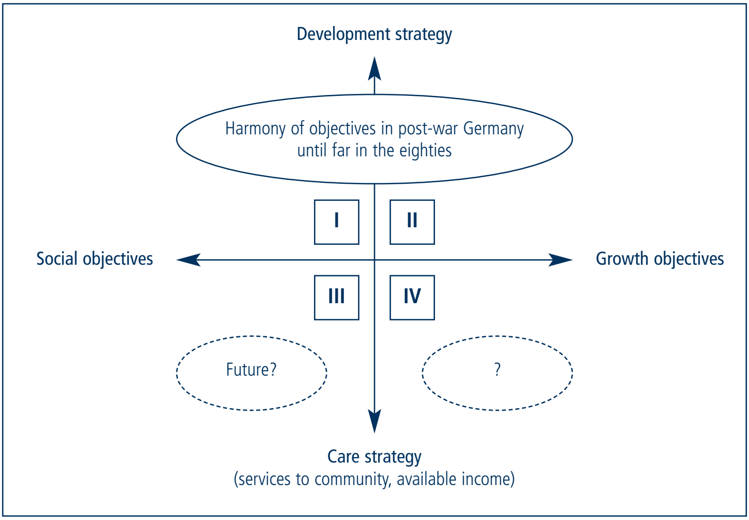
2. REGIONAL STRUCTURAL AND COHESION POLICY

Policies from tax legislation, State aid and employment policy to equalisation payments and regional planning policy have a significant influence on Germany's spatial structure. Regional structural policy may be less important than the others in terms of financial volume, but the focus below is nonetheless on structural policy as it explicitly affects regional development.

Regional structural policy in some cases overlaps with other areas. It is used as a synonym for terms such as regional policy and regional economic policy (e.g. Fürst et al. 1976: 4, Eckey 1995: 815) and cannot be clearly separated from other policy areas.

Regional structural policy can be defined as the area of structural policy concerned with geographical space. Structural policy as a whole, in other words both sectoral and regional structural policy, is the economic policy field dealing selectively with specific areas (e.g. weaker regions or individual sectors such as mining which are experiencing development problems) and which alters economic structure. ECKEY (1995: 815) defines regional structural policy as the overlap between economic and regional planning policy, while EICKHOF (2005: 3) understands regional policy as "all measures aimed at development in one region of a national economy". Traditionally, regional structural policy has been aimed at achieving balanced regional development; as shown in the diagram below (horizontal axis), this can be for either socio-political or growth reasons. Regional structural policy can therefore be explained in both economic and socio-political terms.

Figure 6: Regional structural policy aims and strategy



The socio-political objective (fields I and III in the diagram) is to guarantee all people in all regions the same or equivalent living conditions. When the focus is on growth (fields II and IV in the diagram), on the other hand, the key question is in which region the best overall economic returns can be achieved. As the neoclassical approach is that balanced regional development will ultimately be achieved on its own, i.e. growth in weak backward regions will be particularly strong in future, investments in these regions would consequently produce the best overall economic effects. Structural policy aimed at spatial equalisation according to this school of thought accelerates the natural convergence process (Frey/Zimmermann 2005: 6) and is thus also growth-oriented. Another reason for equalisation-oriented structural policy from a growth policy perspective is that the use of all potential and resources in all areas helps achieve optimal results for the national economy as a whole. Regional structural policy has therefore traditionally focussed on a urban-rural divide which must be overcome for social and growth reasons.

The tools employed by socio-political and growth-focussed equalisation policy are not necessarily mutually exclusive. Spatial equalisation policy in Germany in the past was also pushed forward because further agglomeration was seen as socially undesirable by the general public and to a great extent also by politicians (Nonn 2004: 81ff.). ZIMMERMANN points out that "in the 1960s, when the national government passed the first regional planning act, some were still advocating 'deagglomeration'" (2003: 21).

Permanent growth in both the economy and the population which structural and regional planning policy aimed to spread (e.g. Hahne 2005: 258) meant there was in the past little conflict between efforts to boost growth and those promoting equalisation.

Below are some of the reasons for the rethink which has since occurred; the recognition of potential conflict between growth and equalisation.

- Firstly, the persistence of economic and welfare divides in Germany's regional structure;
- secondly, the "national growth crisis" (Frey/Zimmermann 2005: 6) and the resulting limits on possible distribution (BBR 2005b: 163),
- thirdly, the challenges posed by the reunification of East and West Germany;
- fourthly, increasing international economic integration (known in general terms as globalisation);
- fifthly, theoretical grounds. These include the models developed as part of New Growth Theory (see Chap. 1.2.1) predicting an increase in regional inequalities and particular growth in agglomerations, and current economic development and structural policy concepts such as the cluster approach which advocate the concentration of economic activities in one area.

In general terms, as shown on the vertical axis in Figure 6, there are two main approaches to *how* to organise regional equalisation policy. The first is to attract investment to structurally weak regions, for example with incentives, and then attempt to promote equal economic development in these areas through "catch-up industrialisation", or to support the development of companies already operating at the location (development strategy: shown in fields I and II of the diagram).

The second is long-term support and service provison for people living in weaker areas and the subsidisation of central infrastructures or services of general interest such as shops, education, health etc. (service provision strategy: Field III). In the past, the development strategy dominated, not least because long-term support cannot be justified in a growth-oriented equalisation policy (field IV).

However, if balanced regional development does not necessarily produce the best overall growth – and there is a growing consensus that this is the case, indeed this can be deduced from new spatial economic theories and models – it may be sensible in cost efficiency terms to develop only those areas with particularly high competitive potential (field II in Figure 6) whilst providing long-term support for weak areas (field III). According to LAMMERS from the Hamburg Institute of International Economics, regional policy is only worthwhile in national economic terms if "the transfer it creates in the target regions produces economic returns in excess of the losses in those regions from which resources are removed" (Lammers 2004: 624). LAMMERS'S response to structural policy in the former East Germany is that "development funds must on no account be concentrated on weak regions, for example on the grounds that regional disparities in eastern Germany would otherwise grow" (Lammers 2004: 625).

The sub-chapters below address the tensions surrounding regional structural policy (Chap. 2.1), discuss the possible effects of structural policy with a stronger focus on growth (Chap. 2.2) and consider the spatial implementation framework and implementers including in particular the potential role of public regional banks (Chap. 2.3).

2.1. Regional Structural Policy: Growth versus Equalisation

Previous years had already seen a focus on regional cooperation and networks in certain areas of regional structural policy. A trend is now emerging towards more or less systematic support for promising sectors and therefore also the concentration of subsidies on regions with particular potential.

Even if the process is gradual and is attracting some criticism, the EU, the Federal Republic of Germany and the individual federal states in Germany are currently moving from equalisation policy to a regional policy focussed on growth (e.g. Crow 2001: 30, Zimmermann 2003: 19, Benzler/Wink 2004: 259). Similar processes can also be observed in many OECD countries (Swiss Expert Commission "*Überprüfung und Neukonzeption der Regionalpolitik*" [Examining and Rewriting Regional Policy] 2003), for example in Swiss regional policy. "Swiss regional policy was traditionally aimed primarily at equalisation between peripheral and central regions", says BARJAK, "but new regional policy has heralded a paradigm shift: it now relies on regional strengths and potential as the basis for economic growth" (14 December 2004).

Regional structural policy's traditional function is to help reduce regional economic divides and generate a self-supporting upturn in weak regions. However, there is currently a trend towards new approaches and a greater focus on growth within structural policy. At this point in time it is impossible to assess how extreme this change will be in practice, or whether in the long term it will reduce or increase regional disparities. "This is only the beginning of a fundamental debate on how much regional inequality our society can or will tolerate" (Blotevogel 2006: 8). In the light of the current debate, it would appear that structural policy is moving towards a greater focus on growth objectives but that this will not always be systematically implemented.

In general terms, there are two possible degrees of change under new structural policy: It is on the one hand conceivable, as already hinted by EU Commissioner Hübner for Objective 1 aid, that subsidies within the group of poor member states be concentrated on those regions which have promising competitive advantages, in other words on regions better positioned in economic structural terms. It would on the other hand be possible – and this would be the so-called second degree – to provide structural aid to the most successful cities and regions irrespective of regional needs. Equalisation policy would then have to be based on the transfer of income and securing essential infrastructures in these regions, in other words a support or service provision strategy (see Fig. 6 in Chap. 2).

2.2. The Effects of Competence-Based Structural Policy

The effects of a stronger structural policy focus on regional growth potential should be examined at both a national economic and regional level. The overall economic effects depend on the success of the regions in which competence-based approaches are applied and, despite some reservations, it can be assumed that these approaches will overall lead to national economic growth. In other words, the question is whether redistribution or the broad distribution of scarce growth potential is useful when economic growth continues to be weak. Should the approach here not be to strengthen the relevant economic growth potential?

If these growth poles, promoted by the relevant regional structural and planning policy, become the driving forces behind national growth, weak regions will also be supported in the long-term. However, this would require a shift from the current model of balanced regional development and a change in redistribution mechanisms. A focus on growth cannot be justified solely on the basis that weak and peripheral regions will benefit from growth pole or metropolis-oriented policy through spatial spread effects.

Many are demanding a new understanding of "equal living standards" and proposing a greater focus on the quality of life experienced locally[21] (BBR 2005b, Blotevogel 2006, Hahne 2005: 258). "Equal living conditions" according to HÜBLER "are, however, not simply a question of jobs in industrial locations or clusters: the term 'living conditions' covers a far broader set of factors" (2005: 56). Yet this cannot hide the fact that defining specific areas as low development priorities brings certain disadvantages.

Limiting regional development possibilities and at the same time implementing an unlimited agglomeration policy does not appear useful, particularly not for a decentralised country like Germany which is shaped by a specific path-dependent regional innovation system. "As a result of Germany's *polycentric structure*, major centres are spread around the entire country" (BBR 2005b: 184).

21 The statistics reveal that subjective quality of life correlates most strongly to the unemployment rate and the net migration amongst 19 to 30-year-olds; available income is statistically less important (BBR 2005b: 6ff.). Employment opportunities and not income therefore appear to play an important role. If these findings are confirmed, they must be considered in any equalisation policy aimed purely at service provision.

Thus, although the *Anglo-German Foundation for the Study of Industrial Society* rates not one German city amongst the top 10 most important in the world (Frankfurt is in thirteenth place), Frankfurt, Hamburg, Munich, Düsseldorf, Berlin, Stuttgart and Cologne are 7 of the world's 100 most important cities. Britain on the other hand is home to the most important global player, London (No. 1 in the study), but has no other city amongst the top 100 (Beaverstock et al. 2001: 5).

Moreover, cumulative effects can lead to social inequalities in regions which are so to speak left to themselves – regions which receive no economic development support. Such inequalities have costs for the whole of society.

Another aspect often neglected is that regions with highly-developed infrastructures, above all in the education sector, also develop talents, skills and resources from which the growth centres in particular then benefit through migration. "A competition economy should not disregard this potential" (Hahne 2005: 259).

A general criticism is that the original theoretical clarity of these new, growth-based approaches has been lost in the course of their popularisation (Perlik/Messerli 2001: 23); that there is no transparent debate on the practical consequences of such approaches and no alternatives have therefore been developed for weak areas; indeed that many in positions of power and responsibility are still "clutching at the 'catch-up industrialisation' straw" (Hübler 2005: 57). Politically, concentrating State aid on growth regions is in fact a difficult strategy to maintain. Cluster tools are therefore in reality often used across the board and aid still *poured in* indiscriminately (Rehfeld 2005). There is thus a danger that structural policy become bogged down in contradictions, on the one hand promoting spatial concentration and on the other consensus-based and seeking a universal distribution of resources.

The situation is therefore ambiguous. Competence-based approaches are linked to overall economic growth targets, yet preventing regions from participating in economic and social development will in all likelihood produce negative effects.

An assessment of advantages and disadvantages, or opportunities and risks, suggests *the right approach is a dual strategy in the form of balanced structural policy*. This would have two aspects: firstly, promoting growth more or less irrespective of equalisation targets, and secondly offering specific programmes for weaker regions in order to stabilise these regions, improve the quality of life, enable participation in economic activity and keep future development options open. The remainder of this study is based on the development of just such a structural policy.

Such an approach appears important not least because the model used in the growth theories presented above tends to be that of a centralised state and it is therefore unclear how it should be adapted for a decentralised economic system. How should the regional hubs, the places innovation is to take place, be scaled? In other words, what is the right level of agglomeration from a socio-political, allocative efficiency and ecological perspective? Spatial economic models and approaches alone do not provide an adequate response. This must be found by considering the national or rather regional context although even then many unknowns remain.

2.3. Levels and Players: A Focus on Savings Banks

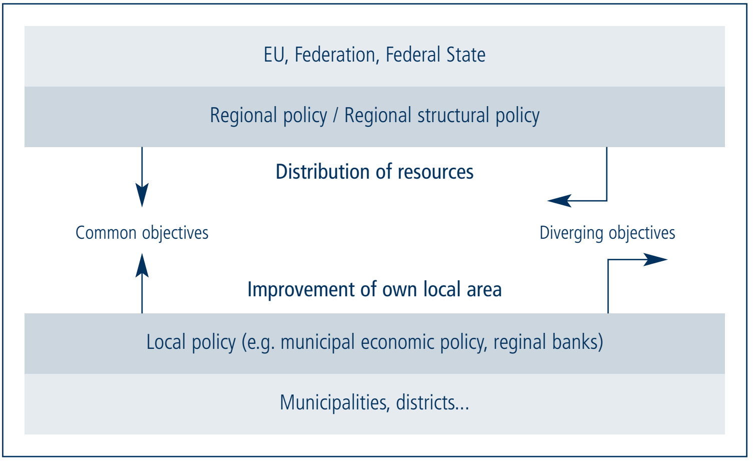
Growth and equalisation-oriented structural policy aimed at promoting endogenous potential is not dictated from the top down; it can merely be supported by the relevant tools and development aid. An examination of the levels at which spatial economic development strategy is implemented on the ground and of the players involved is therefore necessary.

Germany's political structure means that regional economic policy operates at several levels ranging from the EU, country and federal state to the individual municipality (see for example Noll 2006: 77ff.).

LAMMERS offers a clear and simple definition of the various different roles and this is outlined in Figure 7. He terms the spatial economic policy applied by the highest level in the spatial hierarchy *regional policy* (to be understood here as synonymous with regional structural policy) aimed at redistributing resources. This was traditionally done with the aim of equalisation, and now increasingly in order to activate growth potential.

Location policy is organised primarily by municipal business development agencies and is aimed at improving the local area's business location potential (city, district, region) compared to that of other locations. This policy's "*Durchgriffsmöglichkeiten*" ["reach"] (Lammers 1998: 30) is limited to the specific location and it is pursued independently of the structural policy objectives of the broader political and geographic area. The goals of the various levels in this spatial hierarchy are often complementary, for example when a structurally weak region responds to specific EU or federal state regional development programmes aimed at promoting equalisation. Prosperous municipalities and districts also pursue location policy, however, and thus tend to widen the regional economic divide and, although this might further national economic growth targets, it is irreconcilable with the goals of an equalisation-oriented structural policy. Objectives can also diverge at a practical/thematic level. If, for example, a federal state wishes to support a specific type of cluster at one location it considers particularly suitable, the activities of individual local authorities trying to attract similar companies to their district are counter-productive.

Figure 7: Spatial economic policy: implementation levels



Municipalities' and districts' economic policy is known as municipal economic development. Municipalities' work in this fields arises from the principle of municipal autonomy (see GG [German Basic Law] Art. 28) and is an indirect product of their duty to serve the interests of the local population (see also Gärtner et al. 2006). Municipal business development i.e. municipalities' support for their own local economy is not a binding obligation on local authorities, however, and is not legally defined. It can basically be understood as "part of public service provision; municipalities', cities' and districts' duty to secure or further the economic and social good of the local population by creating or improving business location conditions through assistance and support for public and private sector companies" (Schubert 1998: 122).

The implementation level, is often neglected in the general debate on regional structural policy. It should be noted here that municipal business development agencies are by no means the only players in locational policy (Standortpolitik). Locational policy is implemented as regional economic policy by a large number of players. Apart from anything else, this is important because successful location policy focussed less on promoting individual businesses and more on the systematic development of the location depends on a wide range of knowledge and skills, both regional and global, which are provided by a number of different players (see Hamburg/Widmaier 2004). If economic development can be described as a public service incumbent upon the local authority, then location development is the joint product of work by regional players. Other municipal bodies (e.g. city planning office, environment office etc.) and organisations such as chambers of commerce and public regional banks are not the only significant location factors: the companies themselves are also important for their competences define the location's structure.

Public banks tied to the region, namely savings banks, play an interesting part in this policy and one which is more or less ignored in the relevant literature.

- **Firstly**, they have specific knowledge of the location, more than municipal business development agencies do, and can therefore support structural policy based on endogenous growth potential.
- **Secondly**, they can promote the development of regional networks thanks to their proximity to the local business sector.

- **Thirdly**, they are able to develop region-specific financial instruments.
- **Fourthly** and lastly, they enable development in all regions, including weak peripheral areas, with universal access to credit and thus contribute to balanced regional development.

Savings banks are on the one hand able to activate regional growth potential; on the other they support balanced regional development and ensure the provision of public services in all regions, at least in the financial services sector. From a theoretical perspective therefore, savings banks could be key players in the implementation of a structural policy based on growth and equalisation.

Regional banks are an important part of the national and regional innovation system. As defined by COOKE et al., regional innovation systems are "conventionalised in terms of a collective order based on microconstitutional regulation conditioned by trust, reliability, exchange and cooperative interaction" (1997: 490). ROOKS und OERLEMANS, who analysed the innovation system in South Africa, see the "flows of financial capital" (2005: 1207) as one of four key factors which determine companies' ability to innovate.

COOKE et al. draw on new banking theory, pointing out that regional policy aimed at improving finance options for innovations should focus on the relationship between companies and financial intermediaries in order to minimise information uncertainty (1997: 481). Savings banks in Germany (together with the *Volks- und Raiffeisenbanken*) are at the heart of a decentralised and more or less nationwide financing structure, a structure able to deal with regional credit shortages and in line with federal political structures granting a high level of municipal autonomy. Savings banks affect regions' ability to innovate and are thus an integral part of the predominant regional innovation systems in each individual region. However, as they are present in all regions, they are in systemic terms also part of the national innovation system.

PART C - SAVINGS BANKS: STRUCTURE, FUNCTION AND MARKET POSITION

Savings Banks: Structure, Function and Market Position

As demonstrated above, banking systems are key to regional and thus also to national economic development. The following pages examine this phenomenon more closely by looking at public savings banks which operate in all regions.

The public image of municipal savings banks in Germany is an extremely vague one. There is hardly any recognition of the systematic role savings banks with their regional ties could play in a structural policy based on growth and equalisation.

This section of the study therefore considers the function of savings banks in terms of competition, the banking sector and the regional economy and the significance of their regional ties. Chapter 3 describes the savings banks' structure, function and business model, their advantages for the public and their position on the banking market. Chapter 4 addresses the importance and legitimacy of decentralised banks from a structural policy, competition and banking market theory perspective. The following chapter, Chapter 5, highlights problems which can arise when banks are tied to specific regions.

3. SAVINGS BANKS AND THEIR ROLE ON THE BANKING MARKET

Savings banks in Germany are public institutions with a 200-year history but which have adapted in line with economic and social structures. Founded with the philanthropic aim of encouraging poorer sections of the population to save, they have now developed into universal banks with a regional focus. They are public institutions and therefore bound to the local public body responsible for them, usually the municipality, district or joint banking authority. The administrative board appointed by the local council acts as supervisory body and the directors employed are personally responsible for managing the savings banks. Common features of the German savings bank system are set out in the box below.

The German savings bank system: key data (Gärtner 2003: 24ff.)

Establishment: In the early 19th century, to give poorer sections of the population the chance to save and to provide tradesmen with capital.

Structure: Decentralised. Around 470 independent savings banks each tied to a municipality, district or joint municipal association (managing authority).

Legal form: Public institution.

Name: The name "*Sparkasse*" (savings bank) is protected under §40 of the *Kreditwesengesetz* [German Banking Act].

Public service obligation: Savings banks have a public service obligation set out in state savings banks acts and in their statutes which prevents them from concentrating solely on the generation of profits.

The German savings bank system: key data (Gärtner 2003: 24ff.)

EU competition proceedings: The two legal principles *Anstaltslast* [maintenance obligation] (municipalities' liability to the savings banks) and *Gewährträgerhaftung* [guarantee obligation] (municipalities' liability to savings bank customers) ceased to apply in 2005.

The principle of regionalism: Business activities are concentrated on the regions of the bodies responsible. In principle, prevents finance from flowing into growth regions.

Division of responsibilities within the association: The division of responsibilities amongst savings banks, *Regionalverbände* [regional associations], *Bundesverbände* [federal associations], *Landesbanken* [regional federal state banks], public insurance companies etc. allows the savings banks to operate flexibly and independently at a local level.

Three sector system: The savings banks sector is one of the three sectors of the German banking system (private commercial banks; the cooperative and the savings banks sector).

Tension: A public service obligation and focus on the public interest prevent profit maximisation and enable business policy designed for the region; savings banks must however also survive on the highly competitive banking market. Critics of the public banking sector are also calling for the privatisation of savings banks.

This chapter describes the features of savings banks in terms of their legal form and regional ties (Chap. 3.1), the *Sparkassenfinanzgruppe* association of savings banks and its specific business model (Chap. 3.2), savings banks' benefits to the public (Chap. 3.3) and the banking market with a particular focus on savings banks (Chap. 3.4).

3.1. Public Service Obligation and the Principle of Regionalism

As municipal liability in the form of *Anstaltslast* and *Gewährträgerhaftung* (see Chap. 4) no longer exists, the key features of savings banks are now their *public service obligation* and the *principle of regionalism*.

The *principle of regionalism* states that savings banks may only lend to institutions, companies and private individuals in the region in which they are based and may only open branches in that region. The principle of regionalism is directly or indirectly defined under law in the federal states in savings banks acts or in regulations passed on the basis of these acts.[22] Not absolutely binding, it is a basic principle which does allow for some exceptions and can in practice be flexibly applied (Stern 2000: 5). The aim is to ensure that money saved in the region be used first and foremost to boost the local economy and help the local population.[23] The principle of regionalism checks capital mobility and ensures that centripetal backwash effects (see Chap. 1.2.3) are reduced. Depending on perspective and underlying economic theory, this can in theory have either positive or negative effects (see Chap. 1.3).

The term *public service obligation* covers the general public obligations set out in legislation which the savings banks must fulfil and which distinguish them from private banks. The public institutions' public service obligation means that profitability is not their main objective. Profits which are not used to increase the banks' own equity base are to be used for the public good either by the savings banks themselves or by the bodies responsible for them, the municipalities and districts (e.g. Neuberger/Schindler 2001: 88ff.). Savings banks' public service obligation is set out in the relevant savings banks acts of the individual federal states and in regulations and statutes, however it is usually not precisely defined (Gärtner 2003: 17). In essence, the public service obligation covers the following five key features more or less defined in statutory regulations (Sommerfeld 2005, Gärtner 2003, Wengler 2002, Neuberger/Schindler 2001, Völter 2000):

22 There is no general legal definition of this principle (e.g. Sommerfeld 2005: 15ff.).

23 For this reason, the principle of regionalism in this strict form does not apply to the deposit business, "for money deposited from elsewhere also increases local lending potential" (Güde 1995: 42).

The *Wettbewerbsergänzungsfunktion* [duty to increase competition] states that savings banks are to prevent monopolies or oligopolies on the banking market through their nationwide and region-wide presence and contribute to intense competition. The *Gewährleistungsfunktion* [guarantee function] is understood as the provision of finance and lending services for the entire area in which the savings banks operate. Savings banks must also offer banking at reasonable prices in branches with lower profits expectations and in sparsely populated or structurally weak areas.

Both the *Wettbewerbsergänzungsfunktion* and the *Gewährleistungsfunktion* are of far greater significance in peripheral and structurally weak areas than in urban regions. Limiting savings bank functions to weak or peripheral regions on the basis of this fact would, however, put the association system as a whole at risk. This would in turn affect competitiveness, above all that of smaller savings banks in peripheral regions (Henneke/Wohltmann 2005: 1, Keßler/Riekeberg 1999: 281).

The *Struktursicherungs- und Regionalförderungsfunktion* [structural and regional development function] obliges savings banks to support balanced development across the region(s). Savings banks' decentralised structure allows access to banking services in all areas whilst the principle of regionalism prevents money being collected from all areas but "invested only in the economic centres" (Neuberger/Schindler 2001: 93).

The *Hausbankfunktion* and *Kommunalberatungsfunktion* [local authority bank and municipal advisory function] state that savings banks must support the municipalities and districts in dealing with financial matters. However, public bodies' excellent credit rating means that municipal loans are also attractive for private banks and savings banks' share of the municipal lending market has consequently decreased in recent years (Neuberger/Schindler 2001: 100ff.).

Savings banks also have a duty to promote the public's *accumulation of capital* and fulfil an *economic educational function*. Critics often point out that encouraging the population to save is an outdated concept as even people on lower incomes are now able and willing to save (e.g. Karl-Bräuer-Institut 1994: 18ff.). Nevertheless, the nature of this function has changed: in some federal states, for example, it now covers funding for debt advice organisations.

Views differ on what other functions are covered by the public service obligation. In some cases, for example, it is also understood to include the stability of the financial markets and an SME and start-up financing function (e.g. Sommerfeld 2005: 34ff., Neuberger/Schindler 2001: 95ff.).

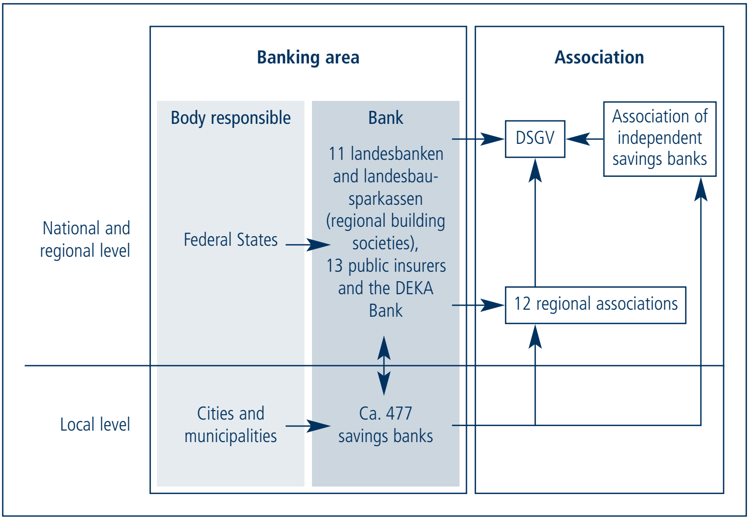
3.2. The Structure of the Sparkassen-Finanzgruppe: The Business Model

Although savings banks are independent in their respective regions, they are all part of the *Sparkassen-Finanzgruppe*. This association plays a key role in efficiently processing downstream activities, thus allowing savings banks to operate flexibly and independently at a local level whilst offering reasonable banking services in their position as universal banks.

The structure of the association is unusual: not purely hierarchical, not purely market-based and not purely voluntary. The association is held together by a mixture of economic rationality, group philosophy, corporate identity, capital connections and laws and standards. GRICHNIK and BÖRNER believe the Group is an example of shared responsibilities and cooperation "above and beyond market and hierarchy" (1999: 6). "The association system offers the individual savings banks (...) all the advantages of a major company but ensures they retain the benefits of a regional, flexible business unit" (Buchmann 2001: 578). A focus on subsidiarity and the principle of decentralisation are key features of the association.

The *Sparkassenfinanzgruppe* has developed over time and grown following the creation or merger of central organisations. It now consists of savings banks, *Regionalverbände* [regional associations], *Bundesverbände* [federal associations], *Landesbanken* [regional federal state banks], public insurance companies, specialised service providers and many other bodies. It includes around 670 companies, employs a staff of approx. 390 000 and claims in terms of turnover – 3.3 billion euros – to be the largest financial group in the world (http://www.gutfuerdeutschland.de/nachrichten/'globaler_champion.html). As shown in the diagram below, the *Sparkassen-Finanzgruppe* is built around certain key banking and association bodies.

Figure 8: The structure of the *Sparkassen-Finanzgruppe* (2004):



The *Deutsche Sparkassen- und Giroverband* (DSGV) is the umbrella organisation representing the *Sparkassen-Finanzgruppe*. It coordinates decision-making within the Group and determines strategic direction.

The *Landesbanken* are the savings banks association central banks and as such are responsible in particular for processing transactions, EDP development, cash pooling amongst the savings banks, securities transactions and foreign business. Public insurance companies were integrated into the association as part of the *Allfinanzstrategie* [comprehensive financing strategy] (e.g. Sommerfeld 2005: 17ff.).

Responsibilities are allocated within the system in two different ways. *Vertical division* covers the division of responsibilities between the savings banks operating on the ground and the association. Savings banks concentrate on the region and are thus rapid and flexible; they use the association system to process bulk back office business and for specialised competences.

Horizontal division means that savings banks may only operate in their own region and are thus not in competition with each other. From a business perspective, limitation to one region at first appears counter-productive, but savings banks specialise in smaller loans for which costs can only be covered if the fixed costs, in this case credit check costs, are low thanks to close customer contact.

3.3. The Benefits of Savings Banks

The benefits of savings banks are many and varied and can be discussed at various different levels. The banks' actual function, the justification for their status as public institutions, is to ensure *access to finance* for all companies and sections of the population in all regions.

One question arising in the context of this study is whether savings banks can demonstrate inherent structural policy benefits through an ability to activate overall economic growth whilst also contributing to balanced regional development. It should be remembered that although the original role of savings banks was that of financial intermediary, they do fulfil other important regional development functions.

Literature in the field adds the following aspects to the banks' actual function as financial intermediary:

firstly, savings banks locally generate *high tax revenue* (e.g. Möllring 26 May 2003). Secondly, they play an important role as local employer and traineeship provider (e.g. *Städte- und Gemeindebund Nordrhein-Westfalen* 6 April 2005). Thirdly, they provide important *cultural and social benefits* in the regions through sponsorship, donations and their foundations; also through dividends paid to the bodies responsible for them which are usually city and district authorities. As these aspects are not, however, a direct result of savings banks' function as financial intermediaries and therefore do not justify financial intermediaries coming under public law, they shall not be the focus of the discussions that follow.

3.4. The Role of Savings Banks on the Banking Market

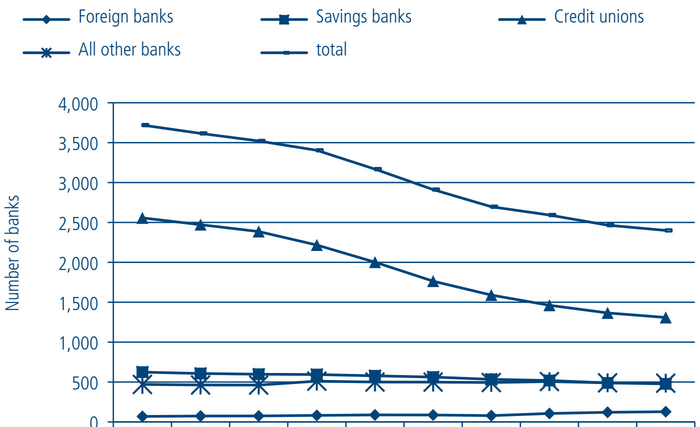
The banking system in Germany is split into three main areas. The first consists of commercial banks, most of which are joint stock companies. These include both the *Regionalbanken* [independent regional banks], branches of foreign banks and the five major German banks (Deutsche Bank, Dresdner Bank, Commerzbank, Bayerische Hypo- und Vereinsbank and since 2004 also the Deutsche Postbank). The second area consists of the *genossenschaftliche Banken* [cooperative banks] (around 1 338 independent institutions) plus the central cooperative institutions; the third covers the approx. 477 savings banks and the *Landesbanken (Regional Federal State Banks).* All banks in these three sectors are so-called retail banks, i.e. they carry out all standard banking business and operate using a branch system.

Elsewhere in Europe, unlike in Germany, the banking market has seen large-scale legal reform and reorganisation and (partial) privatisation (Engerer/Schrooten 2004: 74, Hakenes/Schnabel 2005: 2). The German banking market differs from other European markets in the major role played by public banks, the strict separation between the three banking sectors and the horizontal division of responsibilities within savings bank and cooperative bank associations.

3.4.1. The Structure of the Banking Market in Germany

2 229 independent financial institutions, 678 800 employees and 42 659 branches (figures from 2004/DBB 2005d: 23): the German banking market is seen by many as *overbanked* and *overbranched*. A fundamental distinction must however be drawn between the number of banks and the number of branches. Germany's banks, as shown in the diagram below, have been undergoing a process of concentration for several years now. This process has slowed but will, the Deutsche Bundesbank believes, continue in the future (DBB 2005c: 103).

Figure 9: Consolidation of the German Banking Market 1995-2004



	95	96	97	98	99	0	1	2	3	4
Foreign banks	69	74	75	82	88	87	79	106	121	128
Savings banks	624	607	598	594	578	562	534	519	489	477
Credit unions	2,557	2,472	2,386	2,217	2,002	1,764	1,590	1,462	1,366	1,309
All other banks	470	463	462	511	500	499	494	506	490	486
total	3,720	3,616	3,521	3,404	3,168	2,912	2,697	2,593	2,466	2,400

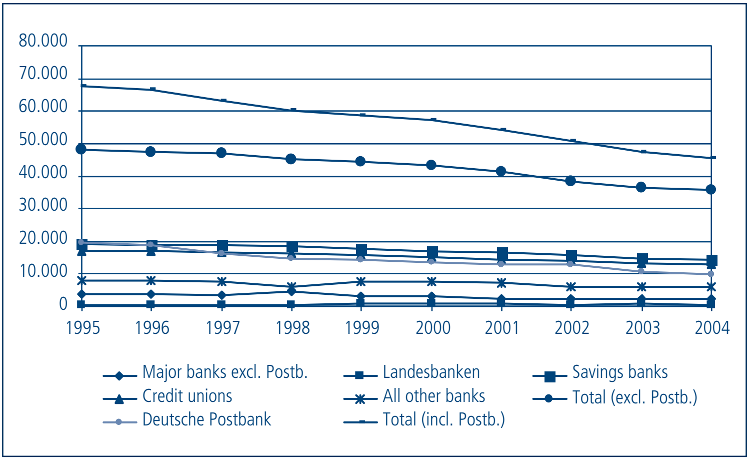
Source: DBB 2006a (bank branch statistics), author's calculations

In the course of this consolidation process the number of independent banks in Germany fell from 3 720 in 1995 to 2 400 in 2004, largely as a result of mergers. It should be noted that the 477 savings banks on the one hand and 1 309 credit unions on the other each form one association and are not in competition. Were this taken into account, the figure for 2004 would be just 614 and not 2 400 banks.

Mergers, strictly between organisations within one and the same area only, mainly affected cooperative banks whose number fell by around 49 per cent in the space of 10 years, followed by the savings banks which dropped by 24 per cent. The number of foreign banks in Germany nearly doubled over the same period, however the initial numbers here were lower (DBB 2006a/author's calculations).

As shown in the diagram below, it is not just the number of independent banks in Germany which has dropped: the number of branches has also fallen continuously over the last ten years and this by 25 per cent overall without counting Postbank branches[24] (-32% including Postbank branches).

Figure 10: Branch Numbers 1995-2004



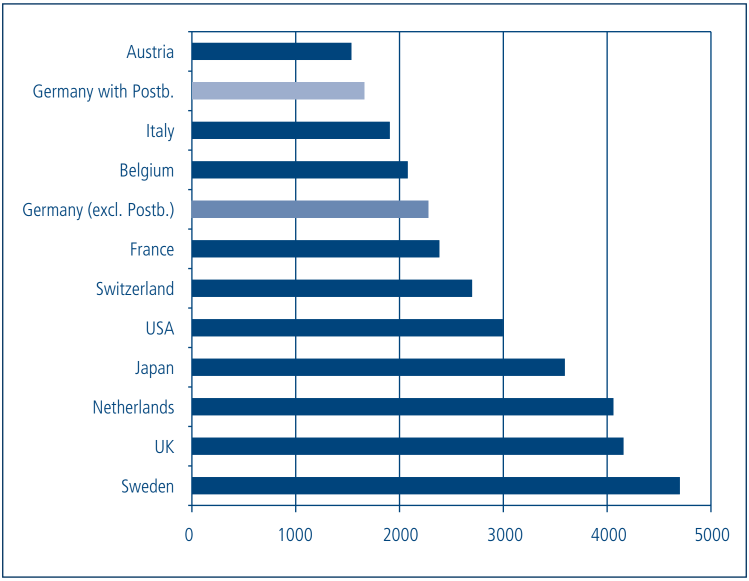
Source: DBB 2006a (bank branch statistics), author's calculations

24 There is no general consensus on whether or not the branches of Deutsche Post AG are to be counted as bank branches. "The European Commission, for example, includes the Postbank whilst the Bank for International Settlements disregards it" (Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung 2004: 289).

Despite the fact that branch closure over recent years has in percentage terms proceeded fastest in the savings banks sector (excluding the Postbank), the savings banks in Germany all together are still running the most of all banks' branches.

An examination of the average population a bank branch has to serve (financial institutions' branches and headquarters) is a useful basis for assessing the intensity of the service and supply network (see Fig. 11). The higher this figure, the lower a country's ratio of bank branches to population. Based on this calculation, each bank branch in Germany in 2003 had to serve an average of 2 280 people; this figure drops to 1 660 if the 10 000 Post AG branches are included.

Figure 11: Head of population per bank branch in 2003



Source: DBB 2005b, author's calculations

In other words, each bank branch in Germany serves a smaller number of inhabitants than is on average usual in the EU; Germany's network of bank branches is thus closer than the European average. This close bank network does generate costs but it also offers benefits for the local population - benefits which become clear when contrasted with the banking markets in Anglo-Saxon countries (see box below).

A comparison with foreign markets

The banking market in the UK, dominated by private banks, has long been criticised for failing to provide adequate services in poorer districts, peripheral regions and for certain sections of the population - despite the fact that it is constantly cited by private banks as a positive example of profitability. However, this last is not due to increases in market efficiency, but rather to "higher prices and margins, as one would expect for an oligopolistic market with small number of largely similar competitors" (Hackethal/Schmidt 2005: 22). "The withdrawal of banks (…) from poorer areas may make commercial and shareholder sense for the companies involved, but it effectively produces areas of financial exclusion" (Martin 1999: 21). The Cruickshank Report commissioned by the UK Treasury (Cruickshank 2000) found a lack of access to finance, above all for small and medium-sized businesses. There are also entire districts and regions with no access to financial services (Martin 1999: 20ff.). This service gap in Britain has traditionally been filled by so-called moneylenders who usually lend private funds at high rates of interest (e.g. Sinclair 2001). In an effort to combat this, government support has been given to community development financial institutions and credit unions aimed at closing the service gap. These include various types of non-profit financial intermediaries, in some cases local initiatives, which offer financial products such as micro-lending suited to very small businesses and poorer sections of the population (e.g. Gärtner 2003, Collin et al. 2001).

1977 saw the "Community Reinvestment Act" (CRA) passed in the USA in an attempt to improve what was poor banking service provision in certain regions and districts. It called on banks to offer products and services in weak regions and to poorer sections of the population. Following intense criticism of the CRA, the act was reformed in 1995 with the aim of reducing its administrative complexity and making it more effective. However, the CRA is basically a voluntary regulation and has little legal weight. It works primarily as an image factor as banks who meet its guidelines can use this in their publicity (Hakenes/Schnabel 2005, Gärtner 2003, Reifner et al. 1998: 38ff.).

Yet in Germany, too, not all regions have an equally good network of bank branches and there are regional variations in competition on the banking markets. Urban areas, in particular those with a flourishing economy, usually have branches of all private commercial banks, cooperative banks and savings banks; a significant number of peripheral regions, on the other hand, are served only by the two latter (Engerer/Schrooten 2004: 33, *Sachverständigenrat zur Beurteilung der gesamtwirtschaftlichen Entwicklung* 2004: 292). Competition on the banking market is less intense in eastern Germany than in the west of the country as there are fewer cooperative banks and even the private banks are underrepresented. This is true above all in peripheral regions. Savings banks' dominance in eastern Germany is also a result of the key position they held in the deposit business in the former GDR (Nagelschmidt/Neymanns 1999: 17, 23).

3.4.2. Profitability and Trends

Germany's banks are comparatively less profitable in European perspective (zeb[25]). There could be two main reasons for this: either the banks in Germany operate less efficiently or the intense competition leads to lower prices and thus lower profits. A recently published study by the *Kreditanstalt für Wiederaufbau* (national German promotional and funding bank) concluded that the German lending business is extremely productive compared to others around the world and that instead of generating high profits this produces more attractive conditions for banking services (KfW Bankengruppe 2005). A recent study by the *DIW* [German Institute for Economic Research] also shows that parts of the public banking sector, and this means above all savings banks, work extremely profitably (Engerer/Schrooten 2004: 78). Cooperative and savings banks were therefore also affected far less than the major private banks by the slump in profits experienced by the banking industry between 1995 and 2004 (DBB 2005a, DBB 2006b). According to the Deutsche Bundesbank, institutions focussed on steady business with small investors, home building loans and small and medium-sized companies suffered less from the bleak profit situation on the banking market (72). Many put private commercial banks' poor showing down to a rapid and extreme change in business strategy and withdrawal from the SME lending market (Fröhlich/Huffschmid 2004: 117ff.).

25 These data come from the European Banking Study 2004 and were kindly provided by zeb/rolfes.schierenbeck.associates GmbH.

The fact that savings banks have fared better than private commercial banks in spite of their public service obligation, regional ties and the commitments this imposes raises an interesting question, namely whether their success is *due to* and not *in spite of* the public service obligation. For indeed, this obligation forces savings banks to remain within and make a strong commitment to one specific region and this necessarily creates high market recognition. "That they are more successful may be due to the conservative or conventional business policies which they have not only chosen to pursue but which were as imposed on them by the restrictive regulation in the relevant laws and by their ownership and governance structures" (Hackethal/Schmidt 2005: 16).

The private banks' view is that "the main reason why German banks are lagging behind" is "the large State share in the financial sector and the way the banking industry is structured in three clearly defined groups" (*Bundesverband deutscher Banken* [Association of German Banks] 2004: 11, Potthoff 16 July 2005). Indeed there is, from their perspective, some truth in this argument: private banks have only very limited means of implementing a strategy based on close customer ties and regional focus. A joint stock company operating at an international level has little scope to grant its individual banks independence and decision-making powers such as those enjoyed by municipal savings banks. Moreover, private banks lack the strong local structure they would need for economic success on a regional market owing to the powerful position held by the savings banks and cooperative banks.

Nevertheless, for a few years now the German banking market has been changing as a result of altered customer attitudes, structural changes by the service providers, a wave of automation driven by developments in information technology and the liberalisation of the markets.

Retail customers are increasingly willing to do without personal advisory services and a branch network for the sake of more favourable terms and conditions. "This is no passing fad: the trend towards cheaper products and services is now firmly established" claimed an article in the *Frankfurter Allgemeine Sonntagszeitung* (Hoffmann, 8 May 2005). Profit expectations have risen considerably, in particular those of wealthy retail customers (*Bundesverband deutscher Banken* 2004: 9).

The change in customer attitudes corresponds to the increase in competition amongst suppliers. So-called near-banks and non-banks offering only very specific products – usually highly standardised – and direct/Internet banks are increasing the price competition faced by banks with branch networks. The former do not maintain a cost-intensive branch network and specialise in those sections of the value chain which are most profitable for them (*Handelsblatt* 22 November 2005, Gärtner 2003). Savings banks are particularly badly affected by this as they do operate a cost-intensive branch network. The Deutsche Bundesbank believes that not only has competition in the deposit business intensified with the entrance of new players, but "at the same time greater competition is increasingly affecting the lending market for private households i.e. consumer lending and mortgages" (DBB 2005c: 72).

Savings banks' difficulties here could moreover be exacerbated by harmonisation and standardisation (Basel II and scoring models) which may potentially reduce the importance of regional banks' competitive and information advantages arising from a better knowledge of their customers (see Chap. 1.3.4).

The challenge facing savings banks for the future is to survive the increasing cost competition which a broad range of factors are now producing and continue to offer high quality advisory services in all areas (see also the comments of the Managing Director of *Sparkasse Darmstadt* [Darmstadt savings bank] in Chap. 7.1.3). Discussions have been ongoing in the savings bank sector for some few years on making more use of the association and reducing the range of processing work which local savings banks have to deal with. The association already makes a significant contribution to savings banks' economic success but full use is not being made of potential scale effects. Some individual savings banks have joined forces to establish so-called *regionale Abwicklungs-gesellschaften* [regional processing companies] but such collaborations are still rare. Further interregional cooperation and mergers are also being considered to improve efficiency at the *Landesbanken* (Regional Federal State Banks) (e.g. Süddeutsche Zeitung 30 October 2006; Potthoff 16 July 2005; Mußler 5 November 2005: 13). Former Chairman of the Board of Directors at DekaBank, WEBER, stresses that everything depends on striking the correct balance between centralised and decentralised tasks and functions.

“The question is ultimately this: what level of decentralisation can we still afford, and what level of centralisation should we accept?” (Weber 16 October 2004). The aim of cooperation is to drive forward closer collaboration within the *Sparkassengruppe* and thus make better use of the association’s scale whilst maintaining savings banks’ regional independence. Experts at the savings banks studied believed a greater focus on returns is needed alongside cost considerations, in other words local value creation in the region must be increased (see in particular the information on the Biberach savings banks in Chap. 7.3.3).

4. SAVINGS BANKS FROM A COMPETITION, REGIONAL ECONOMIC AND BANKING THEORY PERSPECTIVE

Doubt has been cast for some years now on the legitimacy of Germany's public savings banks' unique status. Media awareness of this debate rose when competition proceedings were launched in January 2001 by the EU Commission[26], which was particularly critical of the municipal liability systems of *Anstaltslast* (body responsible's liability to the savings banks) and *Gewährträgerhaftung* (body responsible's obligation to cover third party liabilities). An agreement reached with the EU Competition Commission in 2001 resulted in the abolition of municipal liability obligations in mid-2005 but the dispute is by no means over. Indeed, it would appear that the end to State liability has changed perceptions (e.g. Engerer/Schrooten 2004: 17, Fischer/Pfeil 2004: 343ff.). SOMMERFELD (2005) claims the German system is under "constant European legal fire".

What should be the response to questions on these banks' right to operate as public institutions? Does their legal form generate costs through unfair competitive advantages and by preventing the efficient allocation of resources or, as savings banks representatives suspect, is the real issue behind such questions the removal of troublesome competitors? Does the public interest justify the retention of public, decentralised banks?

The sub-chapters below analyse the advantages and disadvantages from a theoretical perspective, examining banking services as public services (Chap. 4.1) and considering decentralised banks' influence in terms of both regional structural policy (Chap. 4.2) and banking market functions (Chap. 4.3). The chapter concludes with a summary of the overall situation (Chap. 4.4.).

26 For details, see Gärtner 2003: 41ff.

4.1. Banking Services: Essential Public Services

Under the principle of municipal autonomy (Art. 28 Par. 2 GG), Germany's cities provide a range of economic, social, welfare and cultural services of general interest which contribute to the quality of life in and the profile of these cities. These public services are currently at the centre of a number of conflicts and tensions. Discussions are underway at all levels of the political hierarchy (country, federal state, municipalities) on outsourcing, privatisation and public-private partnership models, and the sale of public companies is being considered as a way of mending the public finances. Increased efficiency is the argument often used in favour of privatisation, as for example in a publication by the *Bundesverband deutscher Banken*. "Yet another reason for a purely private sector banking system is the fact, proven in a number of studies, that public companies operate less efficiently than private ones" (2004: 39). However, this claim cannot simply be applied to public savings banks without further consideration, as explained in Chap. 3.4.2; this is reflected by the fact that although public *Landesbanken* have been badly hit by the financial crisis which broke in 2008, public savings banks are surviving the crisis and thus helping stabilise the German banking market. It should also be noted that savings banks are not, unlike former State companies such as the Deutsche Bundespost or State energy companies, monopolists.

Competition disputes at a European level must also be considered alongside the debate surrounding savings banks within Germany. It was inevitable as the EU's regulatory powers increase that European law affect the German tradition of municipal autonomy (e.g. Articus 2002: 7ff.).

The understanding of *Daseinsvorsorge* (Germany), public service or service public/servicio publico (in France and Spain respectively) differs from country to country[27], not least because views vary on whether the State should be purely regulatory or whether it should itself offer services of general interest to prevent potential allocative market failure.

France on the one hand and the United Kingdom on the other represent the two opposite extremes: State public service in the former is enormously important, while in the latter most services are provided by the private sector (Sommerfeld 2005: 94).

27 The Neue Zürcher Zeitung, for example, talks about the "public service myth" in relation to savings banks (Neue Zürcher Zeitung 22 June 2005).

The key question as regards savings banks is how far individual countries are entitled to guarantee certain companies special status in order to ensure the provision of basic necessities in all areas. Unlike the German Basic Law or *Grundgesetz*, which assumes the political economic neutrality of the constitution, the EC Treaty explicitly recognises an economic system of free competition following the principles of a market economy (Sommerfeld 2005: 80).

This raises the question of how far banking markets differ from other markets and whether State intervention or public companies are therefore justified. One convincing argument in favour of imperfect financial markets is the information asymmetry in the lending business which can lead to credit rationing, above all in weak and peripheral regions (see Chap. 1.3.2). It must also be remembered that transactions in the banking sector are never absolutely secure despite formal contractual rights, not least because the provision and repayment of credit are inter-temporal. If there is a lack of financial intermediaries in the periphery – and this would presumably always be the case in a private sector banking system – banks do not have sufficient access to information and this can mean even promising investment plans in the periphery fail to obtain funding (e.g. Fischer 2005: 88ff., Freixas/Rochet 1997: 15ff., for public banks see also Dybe 2003: 225).

4.2. Savings Banks in Regional Structural Policy

The choice of economic theory dictates whether or not analyses conclude that savings banks make regional economic or structural political sense. From a neoclassical perspective, public banks are not a structural policy necessity (Nürk 1995, Neuberger/Schindler 2001: 93): flourishing regions initially attract capital, however after a certain point the process reverses as capital becomes less scarce and its marginal productivity in these regions decreases; this then leads to regional equalisation. The principle of regionalism in part prevents such capital mobility, in some cases forces finance to be used inefficiently and prevents regional equalisation and is therefore deemed counter-productive within this theoretical framework (Nürk 1995).

However, an assessment of the real situation clearly reveals the inability of neoclassical theories to explain actual economic spatial structures. A series of newer theories and approaches, such as polarisation theory and New Growth Theory, work on the assumption that there is regional imbalance in economic development (see Chap. 1.2.1 and 1.2.3). The essential aspect of these approaches is that positive external effects in agglomerations lead to cumulative growth at the expense of weaker (peripheral) regions. Such growth can in the absence of State intervention lead to regional inequalities.

"A complete nationwide distribution of resources such as that ensured by the *Sparkassengruppe* is perfectly appropriate if the regional development policy pursued is one of equalisation, but if the aim is to foster specific growth centres or poles the (national) concentration of resources is essential" (Wengler 2001: 299). In theory, there is therefore a risk that savings banks hinder the desired concentration process by keeping capital in weak regions.

Does this make savings banks counter-productive in the light of newer, competence-based approaches? Not at all: if pursuing balanced structural policy also aimed at equalisation[28], what matters is keeping development options open in all regions and ensuring the efficient and cost-effective organisation of public services. Savings banks can make an important contribution to the realisation of these goals. The implementation of growth-oriented structural policy also requires players who recognise and develop competitive potential locally, and support further development with appropriate financing tools.

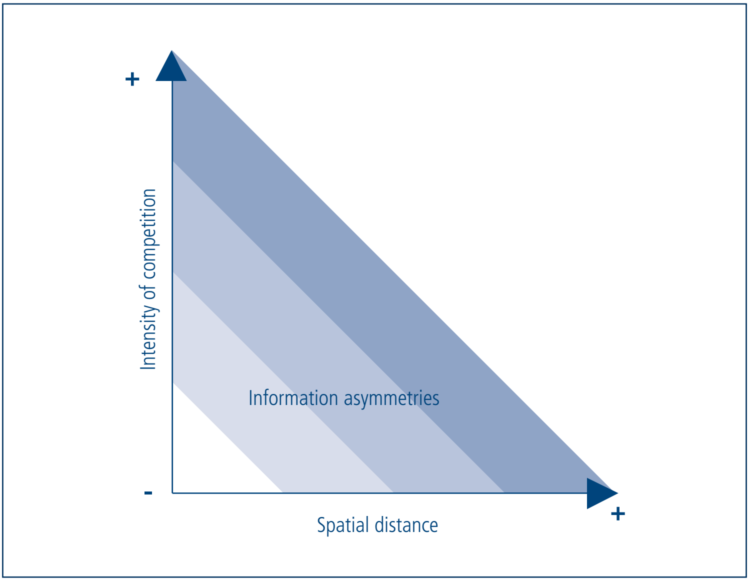
Experts interviewed in the course of this study (see appendix) were also of this opinion, and even the strong advocates of a growth model-based structural policy did not believe that partial capital immobility caused by the principle of regionalism risked obstructing growth. On the contrary, experts rather suspected that savings banks in weak regions relieve the State of certain responsibilities and keep future development options open without withholding resources from the growth regions.

28 A complete renunciation of equalisation objectives should for legal and political reasons be possible neither in Germany nor at a European level. The question is not whether to aim for regional equalisation in future but the level of equalisation and how this should be organised.

4.3. Savings Banks from a Banking Perspective

The section below assesses the significance of public decentralised banks from a banking theory perspective in the light of the new banking theory argument that information asymmetries between borrowers and banks can lead to credit rationing (Chap. 1.3). As shown in the diagram below, the extent of possible information asymmetries can be modelled according to the intensity of competition and the level of separation, which in this case is not simply geographical but also institutional, cultural or social distance (see Chap. 1.3.4).

Figure 12: Information asymmetries in the banking industry

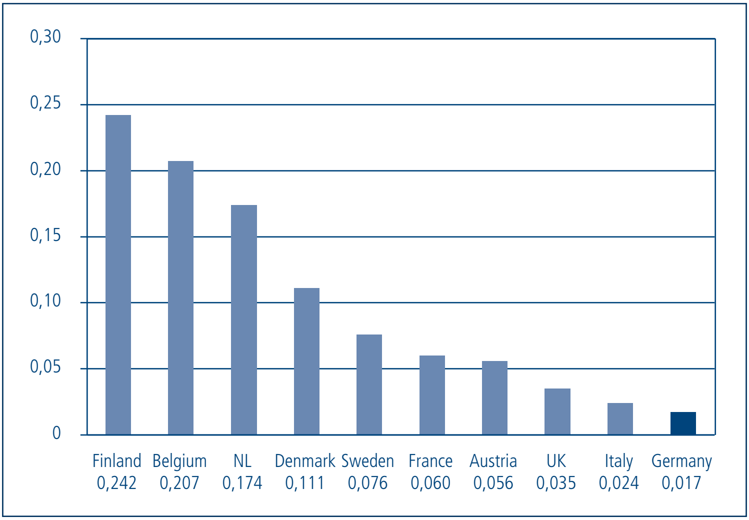


Limited competition does however pose a risk, namely that banks generate oligopoly profits and become inefficient owing to a lack of competitive pressure (see Chap. 1.3.2). International governmental organisations are therefore focussing on increased competition, complete privatisation and opening up the markets as part of financial market globalisation (Fischer/Pfeil 2004: 292).

Applying the findings from this model to the specific structure of the banking market in Germany produces the following picture:

Germany's banking market when compared to those of other countries has low concentration and intense competition at a national level.[29] Concentration on the banking market is defined using measurements of market structure, for example the "concentration ratio" which gives the percentage market share of a set number of the largest banks, or the "Herfindahl-Hirschman Index" – the sum of the square of each bank in one market's market share – which factors in both the total number of banks and their respective market shares (DBB 2005c: 108, Fischer 2005: 21). The diagram below shows the 2003 Herfindahl-Hirschman Index for Germany and selected European countries. It reveals that concentration, which indicates extremely intense competition, is lowest in Germany.

Figure 13: Herfindahl-Hirschman Index 2003 for selected EU countries



Source: DBB 2005c: 108

29 High concentration on the banking market is usually taken as meaning a low level of competition, and this has also been empirically proven (e.g. Fischer 2005).

The low concentration and intense competition at a national level is due primarily to the large number of cooperative and savings banks (see Chap. 3.4.1). Measures of national structures are, however, limited as they do not take account of regional markets. The level of competition on regional markets can differ sharply within a country, for example between urban and rural areas, and is in any case lower at a regional than at a national level. It must also be remembered that savings banks and credit unions each form one association and are not in competition. The approx. 470 savings banks and 1 300 cooperative banks in Germany therefore each only operate in one region. All savings banks and cooperative banks are usually considered institutions at a national level, yet at a regional level there is generally only one institution from each group operating on any one local market.

On the basis of traditional banking theory in which maximum competition leads to maximum efficiency, the low level of competition in some regions ought to lead to high prices and limited access to credit. New banking theory by contrast states that lower levels of regional competition can lead to a better supply of credit as long-term relationships between customers and banks progressively reduce information asymmetry. Neither hypothesis – that competition leads to a better and cheaper supply of credit, or that the benefits of proximity and relationship lending balance out the disadvantages of low competition in the SME and in particular the start-up lending business – can be fully empirically proven as there is a lack of regional data. Banking market concentration at a regional level can thus only be examined using more or less meaningful estimates (DBB 2005c: 109).[30]

The various different and in some cases contradictory arguments and theoretical approaches make it impossible to reach a clear conclusion on the effects of the banking market. "In an international comparison, the German banking system stands out as being unique" (Hackethal/ Schmidt 2005: 25) which complicates the situation still further, hence the conclusion of the *Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung* "that an analysis of the German banking market on the basis of conventional measures of consolidation and concentration does not provide a clear picture of (economic) efficiency or the level of competition, or therefore of the allocative efficiency of the system as a whole" (2004: 294).

30 In order to calculate the level of competition at a regional level, FISCHER considered the branches operated in the regions by the individual institutions (Fischer 2005; see also Chap. 8.2)

From a national perspective, savings banks and cooperative banks create intense competition and produce a fragmented banking market; from a regional perspective, the principle of regionalism and the horizontal division of responsibility in savings and cooperative banks this principle involves reduce competition. The "optimal degree of market power" (Fischer 2005: 113) is therefore not the same at a regional and national level. The table below examines the existing level of competition at a national and regional level and discusses the effects that public banks and the three-sector system have on efficiency, stability and allocation.

Table 2: Savings banks from a national, regional and overall economic perspective

Function Level	Efficiency	Stability	Allocation
Theory	Classic economic theory advocates intense competition, but this view is not always tenable as lending to SMEs only becomes profitable through long-term customer	There is an increasing realisation that maximum competition is not vital to banking market stability.	Efficiency, stability and a willingness to undertake expensive credit checks to grant high risk loans to SMEs and start-ups are important factors in long-term allocation.
Country Perspective	From a national perspective, the unique three-sector structure of the German banking market and the fact that savings banks cannot be sold ensures intense competition despite increasing consolidation.	The intense competition seen at a national level could in theory have negative effects on stability.	Savings banks ensure the provision of all standard banking services in all areas.
Regional perspective	As savings banks do not usually compete against each other, competition at a regional level is significantly lower than that on a national scale. Banks' close relationships with customers nevertheless allow them to efficiently finance SMEs and start-ups.	Less intense competition and stable customer-bank relationships promote stability.	There is competition in all regions. Less intense competition can be positive in corporate lending as stable relationships ensure credit rationing is reduced, it can however also enable banks to impose excessively high prices.

Function Level	Efficiency	Stability	Allocation
Overall economic perspectives	Intense competition ensures the efficient provision of banking services for industry and the public. Savings banks' regional focus enables them to grant high-risk loans involving expensive credit checks which are important to overall economic development. Privatisation would lead to concentration on the national banking market, reduce competition in particular in weaker regions and have a negative effect on stable main bank (*Hausbank*) relationships.	The stability of the German banking market is based on stable main bank relationships and banking markets' regional focus.	The existence of savings banks ensures, at least in theory, that companies which would otherwise lack finance have access to credit. Privatisation could moreover have negative consequences for certain sections of the population in some regions.

Efficiency according to classic financial market theories demands intense competition on the banking market,[31] but new financial market theories allow that less competition in the lending business may also contribute to the general good (Neuberger/Schindler 2001: 91). Savings banks' role would on this basis be deemed negative as they increase competition – indeed to do so is part of their public service obligation. On the other hand, the horizontal division of responsibility amongst savings banks and cooperative banks means that competition in Germany at a regional level is significantly lower; savings banks also traditionally have close ties to their customers and are reliable partners in SME financing. Measures of concentration at a national level consequently give a false impression of extremely intense competition which in reality does not exist.

31 Hence Germany is often cited as an example of the link between intense competition on the banking market and attractive prices for banking services and easy access to finance (e.g. Fischer/Pfeil 2004: 316). Savings banks do contribute to intense competition when considered at a national level.

Were savings banks to be privatised or the principle of regionalism abolished, competition at a regional level might initially increase as savings bank would then start to compete with each other. Savings banks (now privatised) would presumably concentrate on the most economically attractive regions and thus increase the regional variation in competition; at the same time cross-sector banking consolidation would also begin at a national level. Less competition at a national level, more intense competition in flourishing urban areas – although differences in the intensity of service provision would presumably also arise within cities - and less competition in weaker regions would be the logical outcome of such a development. There would presumably also be negative consequences for the stable relationships between customers and banks. Competition is necessary in order to prevent customer dependence on banks, however stable relationships are also important if lending services at viable costs are to be guaranteed and this is true above all for smaller companies.

Intense competition is not absolutely necessary for the *stability* of the financial markets and can indeed even be counter-productive.[32] The high level of competition savings banks create at a national level in Germany could, according to new banking theory, contribute to the instability of banking systems. The claim that intense competition is in conflict with banking market stability is based, however, on the assumption that intense competition between banks can be detrimental to stable and long-term customer-bank relationships. The merits of this argument cannot be judged without looking at the regional situation, and at this level competition is less intense and savings banks' principle of regionalism means stable relationships do exist.

Hausbank or main bank relationships can "in some circumstances reduce economic trends' negative cyclic effects on lending. A decline in such close relationships could therefore sharpen procyclic national economic effects which might potentially damage macro-stability" (DBB 2005c: 112). An end to nationwide and region-wide branch networks could further intensify banks' catalytic effect on the economic situation as "local information, often the basis for providing credit to take companies through economic downturns, becomes less important when credit institutions take decisions centrally and with a greater focus on the overall portfolio" (Braatsch 2002: 17).

32 According to the Deutsche Bundesbank, correlation calculations point to a slight positive link between greater market power on the part of banks and financial stability. (DBB 2005c: 116ff.).

Allocation is understood here as the provision of banking services in all areas and at reasonable prices. Allocation depends on both efficiency – only efficient markets can ensure long-term allocation – and stability; "financial crises affect (...) the proper functioning of the allocation mechanism or indeed temporarily disable it" (DBB 2005c: 104). It should also be noted that information asymmetries can lead to credit rationing and this would also prevent optimal allocation.

Both savings banks and cooperative banks have a regional focus and therefore stable relationships with their customers. They are prepared to invest in obtaining information on potential borrowers in the hope of generating returns in the future and can thus offer reasonable terms. Savings banks operate in all regions and offer all banking services, thus ensuring allocation and, as part of their competitive function, reasonable prices.

The German banking market is highly decentralised and has relatively intense competition compared to other financial markets around the world: this was the finding of a report by the *DIW* on behalf of the German Federal Ministry of Finance (Engerer/Schrooten 2004: 33). Nevertheless, in some regions there is an extremely high concentration of market shares among very few banks. Competition would not be sufficiently intense to avoid great dependence on individual banks were it not for the savings banks. There would also be a danger that banking service provision in weak regions cease completely and that this create cumulative effects. Credit rationing and a credit shortage for certain companies could therefore arise in the absence of savings banks and this would have a negative overall economic effect in terms of the optimal use of resources.

4.4. Conclusions from a Competition, Regional Economic and Banking Theory Perspective

In the past, it was assumed that intense competition in the banking sector led to optimum results. Such unqualified assumptions are no longer acceptable in the more recent debate on banking theory.

Intense competition aimed at preventing the dominance of individual banks and ensuring efficient allocation of capital is in theory just as sensible as the call for low competition in the hope that this favour stable customer-bank relationships and reduce information asymmetry.

In view of the fact that many SMEs in Germany depend on good lending services, a good banking environment and a certain level of competition combined with stable relationships are extremely important to economic development. Just such a combination is in theory exactly what savings banks provide: they ensure competition in all regions and stable main bank relationships at a regional level.

State intervention may be justified as information asymmetry can lead to a shortage of banking services in certain regions. Information asymmetries – one would imagine – are especially extreme when the relationship between customer and bank is weak. This is particularly true when banks no longer operate in close proximity to their customers or do not invest in relationships and information because competition on the market is so intense.

Savings banks' structural political legitimacy is sometimes discussed in the light of whether to aim for balanced regional development, or whether imbalances can be accepted for the good of the national economy. This question is irrelevant as savings banks both help develop endogenous growth potential and contribute to regional equalisation. "Their links to the municipality and personal contacts with the *Gewährträger* [municipal guarantor] give them access to a wide range of in-depth information on the region. Savings banks thus potentially have an extremely important part to play in setting up regional initiatives, initiating company contacts and fostering networks." (Wengler 2002: 121).

It is often argued that public financial institutions with a market share of over 40 per cent are not necessary in Germany, a country whose national economy functions well, or that Germany unlike other countries has not yet completed structural reform in the banking sector. It should, however, be remembered that savings banks are not operated by the central government: they are municipal banks originally established by civic initiatives and over which the national government has no direct control (see Chap. 3).

A decentralised public banking system is moreover a logical product of the specific regional structure of the Federal Republic of Germany. Savings banks have tended to be privatised in centralised countries (for example France) but have remained public in countries with a federal structure such as Germany and Switzerland. The decision in favour of privatisation in France and Italy was taken by the central government; in Germany and Switzerland, it would have to be taken by the federal states or cantons (Hakenes/Schnabel 2005: 22).

Critics believe, however, that there are specific disadvantages to a savings banks system, often claiming that Germany has too many banks and branches (see Chap. 3.4.1) and that this either increases the cost of banking services or reduces bank profits. The analyses in Chap. 3.4.2 show that in Germany it tends to be the banks' profits which are affected. Private banks, moreover, have only limited prospects of increasing their returns owing to savings banks' high penetration of the regional market. "For the large private banks, the acquisition of savings banks (...) would hold great promises. They are based on several factors (…), the most evident one is the retail market shares of the savings banks in their respective region" (Hackethal/Schmidt 2005: 20). The private banks talk of "structural deficits on the banking market" which they claim are reflected in a drop in profits for all financial institutions (*Bundesverband deutscher Banken* 2004: 8).

It is ultimately a political question which is more important: ensuring financial service provision, high financial market stability and municipalities' right to act independently in the public service sector or private banks' profits expectations.

5. THE PRINCIPLE OF REGIONALISM: THE DISADVANTAGES OF REGIONAL TIES

The previous chapter demonstrated that savings banks in theory play an important part in both a functional banking market and in regional development, and that this is largely due to their regional ties.

Yet in systemic terms these very regional ties can also have disadvantages for savings banks, disadvantages known in regional economics terminology as lock-in effects (e.g. B. Granovetter 1973, Grabher 1990). These potential effects can be divided into the following categories:

Firstly, there is a danger that regional banks' loan portfolios reflect the regional economy and not be particularly diverse, and that this leads to the *concentration of risks*. Risk diversification is, however, one of the key responsibilities of financial intermediaries (see Chap. 1.3.3.). FIESELER – a member of the Board of Directors at the DSGV – thus sees "the concentration risks arising from the regional nature of the lending business" as savings banks' greatest source of risk (Fieseler 2006: 15). Savings bank associations and *Landesbanken* have for this reason been offering credit pooling at a regional level since 2002. Participating savings banks can put loans which regional concentration dictates pose a particular risk to the individual bank in a so-called *basket* and thus diversify their credit risks. The DSGV and the *Landesbanken* are currently working on a single, national standard for credit pooling aimed at enabling pooling on a Germany-wide scale. This would mean a considerable increase in diversification options (Fieseler 2006, Instinsky 2006). "Combining and selling credit risks makes it possible to exploit risk diversification options within the association and spread concentration risks for individual savings banks across the entire corporate group, concentration risks which the very principle of regionalism creates" (*Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung* 2004: 291).

By 2006, however, only 57 institutions had been involved in credit pooling for at least one transaction. Nationwide pooling offers the Group enormous security advantages over other banking groups and could overcompensate for the lack of risk diversification produced by regional ties. Savings banks must in future be aware of regional risk concentration, identifying concentration not only in terms of sectors but also on the basis of local regional value chains. This awareness will be particularly important if savings banks become more involved in financing regional production clusters.

However, as savings banks in the past had fairly low value adjustment needs compared to those of major private banks, and credit risk swaps within the Group are now on the increase, this aspect will not be discussed further here.

Secondly, there is a danger that although savings banks have excellent knowledge of the local market they may be unable to assess the risk of investments in new technologies or product innovations because of their focus on the local market. Not only can this mean they lack the necessary information to take lending decisions, it can also mean they do not demand enough innovation from their borrowers (Alessandrini/Zazzaro 1999: 85). Specialist competences are however provided by both the association (branch-specific) and by the *Landesbanken*. Savings banks also have a collaborative partnership with *Steinbeis Transferzentrum* in Mannheim which specialises in financing and marketing innovations and provides the banks with expert advice when needed (*Sparkassen-finanzgruppe*, n. d.).

Thirdly, regional saving and investment rates may vary from one region to another and this can mean funds are kept unproductively in one region, or that a region does not have sufficient access to funds. This problem is, however, not widespread either as savings banks can resolved it using cash pools organised by the *Landesbanken* or interbank and proprietary trading.

Fourthly, savings banks' regional ties pose the risk – and this is an interesting aspect in the context of this study – that they *generate lower profits in weaker regions* or be exposed to frequent defaults on loans due to high bankruptcy rates (Martin 1999: 8ff., Alessandrini/Zazzaro 1999: 74ff) and therefore ultimately only make a limited contribution to regional development. This aspect cannot simply be dismissed without further discussion and will therefore be examined in more detail in the following sub-chapter. Chapter 5.2 analyses the latest research in this area.

5.1. Lock-In: The Profitability of Regional Banks in Weak Regions

Although various hedging tools are used across all institutions to protect individual savings banks from economic difficulties, there are no financial redistribution or revenue equalisation systems to support savings banks in weaker economic environments. This raises the question of whether savings banks' returns corresponds to regional structural strength and whether their contribution to regional development – as they are tied to the region by the principle of regionalism – is thus in the long term necessarily lower in weaker regions and there is therefore a danger that they will tend to reinforce regional disparities.

It is generally assumed that regional banks' profits are directly dependent on the strength of the regional economy, hence *Sparkassenfinanzgruppe* representatives' reasoning in favour of savings banks' major regional economic commitment: "savings banks only do well when the region is doing well" (e.g. Stadtsparkasse Wuppertal 2005: 42) or "only when the region is doing well do the savings banks have a firm economic basis" (Haasis, 8 August 2005). Others come to this conclusion on the basis of theoretical models, for example "if companies in the region are doing badly, this has a negative effect on business development for the bank" (Dybe 2003: 225). "One can think of reasons why a regionally distinct banking system may not be an unmixed blessing to the periphery: while such a system may guard against a monetary outflow to the centre, periphery banks are exposed to extra risk where peripheral regions have, as they tend to do, quite specialised and strongly cyclical economies" (Chick/Dow 1988: 240).

Economic instinct would suggest that savings banks in a flourishing economic environment have greater profit potential and can therefore generate higher returns than those in weak regions. Yet if one considers the specific way banking markets operate and the horizontal and vertical division of responsibilities within the *Sparkassenfinanzgruppe*, there are various aspects to indicate that even savings banks in weak regions are capable of generating sufficient returns.

First of all, private commercial banks have withdrawn above all from structurally weak and peripheral regions and abandoned this area to the cooperative and savings banks. The two latter consequently have particularly large shares of the market in these regions and can therefore generate reasonable profits. Secondly, the lower level of local competition can lead to steady customer-bank relationships; this reduces information asymmetries, it becomes worthwhile to invest in obtaining information and loans thus become more secure.

5.2. Analysis of Research to Date

The question of whether savings banks in weak regions are able to escape cumulative cycles relates to both spatial economics and banking/financial market theory. This area of overlap between the two disciplines has been neglected and there is hardly any empirical research which could provide a sufficient response to such a question (e.g. Petersen/Rajan 1995: 408, Fischer 2005). The chapter which follows gives clear details of research design, but below is first an outline of research from the field of finance/banking relating to the questions raised here. This indicates the link between the level of regional competition and the regional availability of credit. These studies do not, however, consider the link between the regional economic situation and the profitability of regional banks key to the questions raised in this study.

Better SME credit access and higher prices in regions with less intense competition: a comparison of regional banking markets in Germany

The most significant research concerning the German banking market and its regional structure is that by FISCHER and PFEIL (2004) and by FISCHER (2005). These studies looked at the concentration of banks at a district and urban county level and analysed the correlation between the prices of banking products and SME access to credit. In the absence of adequate data, however, the regional market shares of the individual banks were derived from the number of branches operated by one institution in one region (Fischer/Pfeil 2004: 309) despite the fact that each branch cannot be assumed to have the same share of the market in all regions and across all sections of the population.

The studies' main findings were that banking market concentration in eastern German regions is higher and the competition therefore less intense. They were also unable to establish a clear difference in concentration between city and country on the banking markets in western Germany; according to FISCHER this was due largely to the high number of small cooperative banks in rural regions (2005: 28). Another key finding was that standardised banking products are more expensive in concentrated markets but access to credit in the SME segment in such regions is also better. This suggests on the one hand that there is a link between the scale of market structures and the level of competition, namely that oligopoly profits create higher prices, and on the other hand that close relationships with customers in less competitive markets can mean a better supply of credit.

Credit provision was estimated on the basis of the proportion of bank loans to the balance sheet total of small and medium-sized businesses. From this perspective, "both the proportion of bank loans on company balance sheets and the proportion of companies whose financial structure includes banks loans are on average higher" (Fischer 2005: 92) in regions with a lower level of competition. A higher proportion of debt finance on company balance sheets points to better access to credit. This applies equally to western and eastern Germany but is more significant in eastern German regions where companies are newer and pose higher risks (Fischer/Pfeil 2004: 338).

FISCHER (2005), moreover, confirmed the theory that credit provision is better in regions with a higher concentration of banks by examining the proportion of firms which regularly receive discounts. *Receiving discounts* means receiving a reduction on invoices for settling trade accounts within a specific period. If banks provide a sufficient credit facility, it is sensible for a company to settle invoices immediately even if they need to take out a loan to do so. FISCHER found a positive statistical link between high concentration on regional banking markets in Germany and the frequency of reductions granted.

Better access to credit for young companies in regions with less intense competition: a comparison of regional banking markets in the USA

One of the most famous studies is that carried out by PETERSEN and RAJAN in 1995 examining credit provision and its costs in different US regions with varying degrees of concentration on the banking market. It was designed as an empirical test of whether the unlikelihood of inter-temporal margin compensation on banking markets with intense competition leads to credit rationing. In point of fact, the study proved that SMEs in regions with less banking competition or where a small number of banks control large shares of the market have better access to credit and more frequently benefit from discounts than those in regions with extremely intense competition. It also revealed that young firms in regions where competition is less intense receive corporate loans on more attractive terms, but long-established companies are charged higher rates of interest than comparable businesses in regions with an extremely competitive banking environment. This price difference in regions with less intense banking competition could on the one hand mean banks in concentrated markets invest in stable customer-bank relationships and are later able to recoup the additional expense (inter-temporal margin compensation) as the lack of competition allows them to impose higher rates of interest. Charging could on the other hand be due to banks in these regions pricing risks less exactly.

Established sectors benefit from more competition and new sectors from less: a comparison of national banking markets

CETROELLI and GAMBERA (2001) compared national economic development and the development of individual sectors in different countries with more or less concentrated banking markets. The results were as follows: the common argument that intense competition leads to better and cheaper credit provision was confirmed, for economic development was better in those countries where competition in banking was more intense. Nevertheless – and this supports the opposing view that greater competition can lead to credit rationing – young, booming sectors which depend on loan finance developed better in countries where bank concentration is higher and competition consequently less intense. CETROELLI and GAMBERA explain their results on the basis of two opposing trends. Firstly, greater market power leads to higher interest rates for loans and limited credit supply. Secondly, the authors refer to new banking theory in which market power leads to investment in customer-bank relationships and can thus mean credit is more readily available. It should, however, be noted that these results are for a number of reasons limited in their usefulness. Assessments of national structures, for example, are only meaningful up to a point: banking markets are local markets, above all in the SME lending sector, and the level of competition can vary widely between different regions within one and the same country as a look at the German banking market reveals (see Chap. 4.3). It is also debatable whether it is the banking markets which are chiefly responsible for the development of individual sectors.

The research outlined above cannot explain the actual link between savings bank returns and the region. The following section will therefore analyse this question, examining whether or not and how savings banks' returns and the provision of credit depend on the regional economic situation.

PART D - SAVINGS BANKS AND REGIONS: EMPIRICS AND REGIONAL STUDIES

Savings Banks and Regions: Empirics and Regional Studies

Part C of this study explained the significance of savings banks from a theoretical perspective. This section looks at how savings banks are involved in structural policy on the ground and addresses the question of whether savings banks in weak regions are also in a position to contribute to regional development.

Savings banks' current function must be considered in any assessment of their potential importance as players in a newly defined structural policy, but this is not the only essential factor. Key is also the question of whether, from an economic perspective, they are able to provide as much support in the long-term to regional development in weaker areas as they do in flourishing regions. At least a cursory look at the situation suggests there is a danger a savings bank's development be determined by the regional situation; that savings banks in structurally weak regions generate poorer returns and thus cannot support the region to the same extent, or are unable to take on the same default risks, as they can in flourishing regions. If savings banks in weak regions were not similarly competitive to those in strong areas, it could even be claimed that they are indirectly responsible for increasing regional disparities.

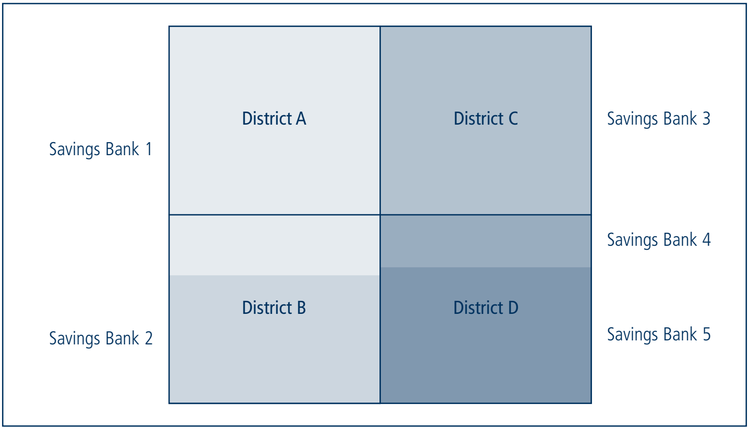
Chapter 6 presents the results of various correlation analyses of whether savings banks are viable in weak regions. Chapter 7 then builds on these quantitative analyses with a more detailed look at the operation and effect of savings banks in the context of regional development using four regional studies. The regional effects of more recent structural policy approaches discussed in the theoretical section are highlighted and discussed using these *regional profiles*.

6. SAVINGS BANKS' REGIONAL ENVIRONMENT AND RETURNS

One key question must be addressed before the relationship between savings banks' success and the regional economic situation in their area can be established, namely how such success – both of savings banks and regions – is to be measured. The relevant data available for different geographical levels must also be comparable, bearing in mind that administrative regions (municipalities and districts) are in many cases not identical to savings banks' business areas.

Alongside *Stadt- und Kreissparkassen* [city and district savings banks] which operate in one district or city/municipality, there are also *Zweckverbandssparkassen* [association savings banks] which cover several municipal areas. Changes in local authority boundaries have resulted in some savings banks operating in several districts belonging to different municipalities. The opposite is also true, i.e. branches of several different savings banks are in some cases to be found in a single district. The link between savings banks' business areas and political districts and the overlaps between these structures are shown in the schematic diagram below: Savings Bank 1 operates in District A and part of District B. The rest of District B is served by Savings Bank 2. Only one savings bank operates in District C. District D is shared by two savings banks which only operate in this one district.

Figure 14: Geographical overlap between savings banks' business areas and administrative regions



Source: author's diagram

For the purposes of the analysis outlined here, savings banks and regions, districts and urban counties were all regrouped at a common geographical level. The market share held by each savings bank operating in several districts was calculated according to the share of the population resident in its business area which it served in each of the districts in question. Corresponding indicators were then calculated to ensure the accuracy of the results. This procedure ensured that the results are meaningful, particularly as the study considers the situation in its entirety rather than merely examining a random cross-section. The precise procedure is detailed in GÄRTNER (2008).

The returns of all 463 savings banks were estimated on the basis of financial *return on equity (ROE)*, the *cost-income ratio (CIR)* which balances administrative expenses against returns and thus constitutes a type of efficiency measurement, and earnings before and after adjustments. The variables were taken from the annual *Erfolgsspannenrechnung* [analysis of income and expenses] following the *Deutscher Sparkassen- und Giroverband* (DSGV 2006) guidelines and are therefore comparable for all savings banks.[33]

Individual logical variables based on indicators from other studies were combined to create a single indicator which was then used to measure the regions' success. This was the process used to create the Regional Economic Development Indicator ('ReDev' indicator) which factors in the rate of population change, the rate of change of those in work and paying social security, gross value added and the proportion of the total working population employed in technical professions. The ReDev indicator is based on an indicator used to determine the regional economic situation on employment markets regions ("Arbeitsmarktregionen") in Germany calculated by the *Bundesamt für Bauwesen und Raumordnung* [German Federal Office for Building and Regional Planning] (BBR 2005b).

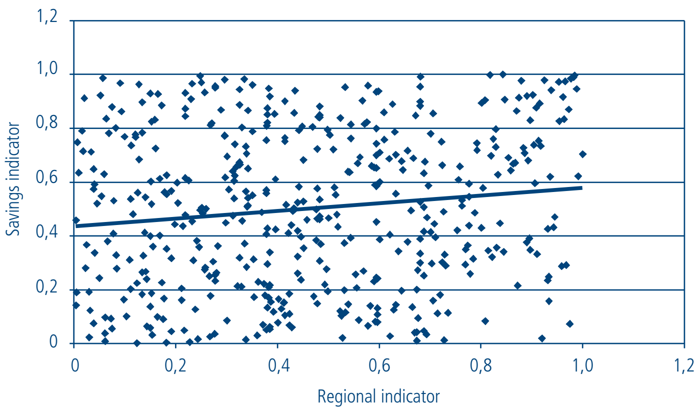
Chapter (6.1) outlines the link between savings bank returns and regional economic strength in their business area using various correlation analyses. Chap. 6.2 explains the results by drawing on both banking and regional economic approaches. The question of whether credit rationing occurs in peripheral structural regions is addressed in Chap. 6.3 and the closing chapter, Chapter 6.4, summarises the findings.

33 The data was anonymised by the DSGV on data protection grounds, so although the correlation could be calculated it was impossible to tell what data related to which savings banks.

6.1. Quantitative Results

The scatter diagram below shows the link between the economic success of savings banks in Germany (the savings bank indicator was calculated according to return on equity, the CIR and earnings before adjustments) and the regional economic situation in the areas where they operate (ReDev indicator) as average values for the years 1999-2003. The ReDev indicator (X-axis) was created using rankings and increases as the regional economic situation worsens. The opposite is the case for the savings bank indicator (Y-axis): the more successful the savings banks, the higher the indicator. The diagram shows a broad spread, clearly indicating that savings banks' returns are not strongly dependent on the regional economic situation in their area i.e. that savings banks in weak regions are not per se less profitable. The trend line even suggests a slight connection between economically successful savings banks and business areas where the regional economy is weak.

Figure 15: Savings bank returns and the regional economic situation in all savings bank areas in Germany (1999-2003)



Source: Statistische Ämter der Länder [Federal State Offices of Statistics] 2004 and 2005, BBR 2004 and 2005a, DSGV 2006 (special analysis). Author's calculations

Further analyses were carried out and correlation coefficients between the ReDev indicator and various savings bank key profit figures calculated for all savings banks in order to establish which profit figures depend on the regional economic situation and in what way.

Correlation coefficients represent the linear statistical link between two variables on a scale of -1 to +1. The values -1 or +1 show a negative or positive "perfect relationship". The coefficients (Spearman's rank correlation coefficient) were calculated with the aid of the statistics programme SPSS. The analyses always covered all savings banks and regions so the level of significance is therefore irrelevant.

Table 3: Correlation coefficients (Spearman) between savings banks and regional indicators for Germany as a whole, western Germany and eastern Germany

ReDev indicator			
Savings bank data	Germany as a whole	West	East
Pre-tax ROE	0.133044	-0.046345	0.031365
CIR	-0.004722	0.079990	-0.222067
Earnings before adjustments*	0.191618	0.066045	0.242761
Earnings after adjustments*	-0.021968	0.025734	0.019544
Interest surplus	0.415788	0.307165	0.237899
Interpreting the correlation coefficients			
In terms of the profit figures ROE, operating income and interest surplus, a positive correlation coefficient here means that savings banks in regions with weak regional economies generate better returns, or that the interest margin is higher in weak regions. As the CIR is lower the better the expense profit ratio, a positive coefficient here means savings banks in weak regions operate less efficiently.			

** Compared to average balance sheet total.*

Source: Statistische Ämter der Länder [Federal State Offices of Statistics] 2004 and 2005, BBR 2004 and 2005a, DSGV 2006 (special analysis). Author's calculations

As the value in the first column of the table shows, ROE and earnings before adjustments are slightly higher in weak regions when examined for the whole of Germany. CIR and earnings after adjustments are hardly affected at all by the regional situation. The correlation coefficients between interest surplus and the regional indicator show an extremely clear statistical link indicating that the difference between interest on loans and deposits is higher in savings banks in weak regions.

For Germany as a whole, therefore, savings banks' profitability is not significantly dependant on the regional economic situation in the area where they operate - indeed they may even benefit slightly from a weak regional economy. It should be noted that all coefficients with the sole exception of the interest margin are extremely close to zero, in other words the statistical link is slight as the scatter diagram (see Fig. 15) already indicated.

A divergence in savings banks' sensitivity to the regional situation emerges if western and eastern Germany are examined separately.

As can be seen from the second column in Table 3, the returns of savings banks in western Germany are less dependent on the economic situation in the region than those of banks in Germany as a whole. Savings banks in western Germany generate either slightly lower or slightly higher profits depending on the indicator used. The statistical link is clearer between high interest surplus and weak regional economic structures.

Eastern German savings banks on the other hand react more strongly to the regional situation as the correlation coefficients show (see Table 3). All coefficients reveal some level of statistical link to indicate that savings banks in weak regions generate higher returns, and this applies most clearly to earnings before adjustments. In eastern Germany, too, the interest margin in weak regions is higher than that in economically successful areas. What is particularly noticeable for the eastern German savings banks is that although earnings before adjustments are better in weak regions, earnings after adjustments are much lower. This indicator shows savings banks hardly react at all to the regional situation.

Ultimately, the most important aspect to note from a German, western German and eastern German perspective is that savings banks in weak regions on average generate similar returns to those in flourishing locations.

Control calculations carried out as part of the study based on the data held by the DSGV on savings banks' business areas confirmed the correlation results. An analysis of the correlation[34] between the average total assets – a reflection of the size of the institution – and variables measuring savings banks' success (ROE and earnings before and after adjustments) produced correlation coefficients of between -0.09 and -0.13. These indicate that savings bank with lower total assets on average post slightly better results[35]. Savings bank representatives interviewed for this study believe one reason for this is that smaller institutions can be managed better or more flexibly and that this makes up for scale disadvantages. The statistical correlation is, however, extremely weak and in any case no proof that size is the cause of the slightly better returns: another possible reason is that savings banks in rural and peripheral regions are smaller and the savings banks in such regions generate higher returns. Causality would in this case primarily be the type of region and not the size of the savings bank. An analysis of the correlation between population density and savings bank size produces a coefficient of 0.481,[36] indicating that savings banks in densely populated regions have a larger market volume.[37] It must also be remembered that savings banks in the east – which are more successful in all areas excepting earnings after adjustment – are on average 32 per cent smaller than western German savings banks in terms of total assets, and that this could also be behind the correlation between better returns and smaller savings banks.

34 In this case the correlation analysis was carried out using Pearson' method as all the variables considered were metric.

35 The CIR changes so little, remaining around zero, that it shows no real sensitivity to the size of the business.

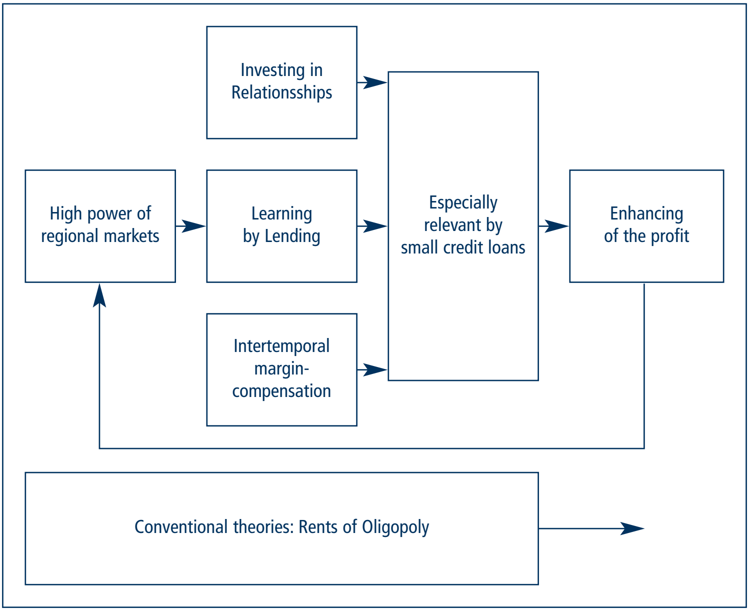
36 This correlation analysis was also carried out using Pearson's method.

37 The fact that savings banks in densely populated areas have larger balance sheet totals strongly suggests savings banks adapt to regional circumstances. If the balance sheet totals in extremely sparsely populated regions were as large as those in agglomerations, this would mean extremely large business areas.

6.2. Interpreting the Findings

The study's main finding is that savings banks in weak regions are similarly successful to those in strong regions. Eastern German savings banks are indeed slightly more successful in weak regions. Savings banks' returns in the east are more dependent on the regional situation than in the west. The analysis also showed that the interest margin is greater in weaker and rural peripheral regions and to a certain extent corresponds to savings bank returns. If one assumes that weak regions are less attractive for private banks and that banking competition is therefore less intense, the banks which do operate in these areas have certain competitive advantages. Below is an outline (see Figure 16) of the effects less competition could have thanks to stable customer-bank relationships, effects which could be one reason even savings banks in weak regions are viable. The diagram draws on the above assessment of literature on the topic.

Figure 16: Relationships on the regional banking market: effects, social capital and regional market power



Savings banks' large shares of the regional market lead to relationship investments. Information is spread asymmetrically and must be gathered and assessed. Willingness to invest in obtaining this information is key to the success of banks involved in SME lending, however they can only afford such an investment if there is potential for a long-term customer-bank relationship (investing in relationships).

Assuming that information and knowledge can be reused, lending is cost-efficient if banks are able to gather and evaluate information over a prolonged period of time (learning by lending). "In the course of time, financial intermediaries may succeed in building up a reputation for secure but profitable investment strategies and thus limit the problems arising from information asymmetries" (DBB 2005, 104).

It is worth a bank's while to invest in relationships and information provided they gain profitable business at later point in time (inter-temporal margin compensation).

This argument is particularly important for savings banks which, unlike private banks, tend to lend small sums to SMEs and young businesses. Large numbers of branches in the region can mean high efficiency as well as reducing transaction costs thanks to stable relationships. This in turn increases these banks' market shares and their market position improves provided there is not a sharp rise in competition on the market; even then competitors do not have the same competitive information advantages and first have to invest in procuring information. Great local market power in structurally weak or peripheral regions can of course also mean that the few banks operating there are able to charge higher prices for banking products (oligopoly profits).

It should also be noted that a bank's information advantages can lead to the abuse of market power (e.g. Fischer 2005: 99), for banks whose economic information advantages prevent other banks on the local market from offering financial products at competitive rates will not be willing to offer major price reductions. A distinction can thus be drawn between two factors which determine market power: on the one hand, market power resulting from oligopolistic local markets and on the other information economics power arising from a bank's knowledge edge. In reality, these two factors probably complement or strengthen each other and this is most likely one of the reasons for the slightly better results posted by local banks in weak (eastern German) regions under both new banking theory and traditional competition theory.

6.3. Do Savings Banks in Weak Regions Provide Adequate Access to Credit?

In proportion to their total assets, eastern German savings banks lend significantly less to retail and business customers than western German institutions, as the table below shows. Loans in the west account for around 58 per cent of the total assets but this figure is only 30.4 per cent in the east. It is hard to explain the stronger effect of regional situation on eastern savings banks in the light of this finding. Western German savings banks' greater lending commitments would rather suggest that these are the savings banks more sensitive to the regional situation[38].

Table 4: Savings bank lending from 1999 to 2003 Germany, western Germany and eastern Germany

	Total loans (retail and business) in % of balance sheet (mean[39])	Loans to retail customers in % of balance sheet total (mean)	Loans to business customers in % of balance sheet total (mean)
West	57.93	28.33	29.60
East	30.39	15.58	14.81
Germany as a whole	53.47	26.27	27.21

Source: DSGV 2006 (special analysis), author's calculations

The data in Table 4 would in fact suggest that eastern German savings banks grant fewer loans in weak regions and therefore have greater funds available for potentially profitable proprietary trading outside the region.

In view of their public service obligation it would be somewhat dubious if, despite a demand for credit, savings banks were nevertheless to invest liquid assets in proprietary or interbank trading simply because they found lending in peripheral or weak regions overly troublesome owing to the smaller sums involved or because they rated the risks as too high.

38 What is more, western German savings banks have less "available funds" and thus can invest less outside the region than eastern German savings banks (interbank trade, proprietary trading).

39 "Mean" is here and in the following the arithmetic mean.

The correlation coefficients in Table 5 do indeed show that savings banks across Germany on average grant significantly less credit in weaker and less densely populated regions; this applies to both retail and business customers. The nationwide German perspective gives a somewhat distorted picture, however: eastern German regions are in general weaker and slightly less densely populated, and eastern German savings banks grant proportionally fewer loans (see Table 4).

Table 5 shows that although there is a slight statistical relationship in western Germany[40] between sparsely populated regions with weak economies and a slightly lower rate of lending to business customers; the opposite is true for loans to retail customers. Savings banks in eastern Germany even grant more loans in sparsely populated regions – to both retail and business customers – than in densely populated areas. Coefficients for eastern Germany relating to regional economic development (the ReDev indicator) are so small that they cannot be taken as showing a statistical relationship.

Table 5: Correlation coefficients between lending, the regional indicator and population density

	Germany as a whole		Western Germany		Eastern Germany	
Regional data	Proportion of personal loans	Proportion of business loans	Proportion of personal loans	Proportion of business loans	Proportion of personal loans	Proportion of business loans
ReDev Indicator	-0.33275	-0.47564	0.07880	-0.13460	0.01798	0.00371
Population density	0.11931	0.24629	-0.03205	0.14692	-0.39844	-0.13142
Interpreting the correlation coefficients						
A negative coefficient for the ReDev indicator means that fewer loans are granted in weaker regions. The opposite applies for population density: in this case a negative coefficient means lending figures are higher in sparsely populated regions than in urban areas.						

Source: BBR 2004 and 2005a, DSGV 2006 (balance sheet statistics), Statistische Ämter der Länder [Federal State Offices of Statistics] 2004, 2005 and 2006; author's calculations

40 The coefficients are however so slight, in particular those for loans to private customers, that this cannot really be termed a statistical relationship.

It is true that the lending figures alone do not provide a sufficient explanation for differences in returns between western and eastern German savings banks, but they at least rule out the possibility that credit rationing in weak eastern German regions is responsible for eastern savings banks' slightly better operating results.

6.4. Conclusions

Firstly, even savings banks in weak regions clearly generate sufficient returns and there is little difference between lending figures in weak areas and those in flourishing regions. Savings banks thus contribute to regional equalisation and could support a structural policy aimed at growth and equalisation. In weak eastern German regions they even generate slightly better results.

Secondly, there is a statistical relationship to show that savings banks in western and eastern Germany have larger interest margins in weak and peripheral regions. This, it would appear, is a result of two factors: on the one hand, savings banks in these regions have less competition to deal with and are therefore able to impose higher prices; on the other hand, slightly higher default risks and higher transaction costs (smaller loans) result in higher loan prices. The large interest margin can also be explained in part by a more conservative approach to investment in these regions.

Thirdly, the size of the institution corresponds to the population density and type of region. Savings banks in sparsely populated areas are smaller (size measured on the basis of total assets). If total assets in sparsely populated regions were on a similar scale to those in densely populated areas, savings banks in sparsely populated regions would have larger business areas. As savings banks in these regions do not greatly extend their business areas, they establish regional ties.

Fourthly, the results largely correspond to research findings in the field. FISCHER (2005), for example, proved that banking products are slightly more expensive in regions with less intense banking competition and that credit in these regions is more readily available. PETERSEN and RAJAN (1995) also reached similar conclusions for the various regions of the USA. Working on the assumption that fewer banks operate in weak regions, the analyses in this study confirm previous findings and correspond to the explanations offered by new banking theory. This last primarily cites market imperfections in the loan financing sector resulting from information asymmetry.

7. REGIONS AND THEIR SAVING BANKS: A COMPARATIVE ANALYSIS

The previous chapter demonstrated that savings banks in weak regions are statistically at least as successful as those in flourishing regions, and that they are therefore in a position to contribute to balanced regional development. This chapter will look at how savings banks are involved in regional development in reality by examining economic development, location policy and savings banks' role in this in four districts and urban counties. The profile of four sample regions should help illustrate the role of savings banks in location structural policy. It should also reveal how regions function in the light of the spatial economic approaches discussed in Part B and the consequences of competence-based structural policy on the ground.

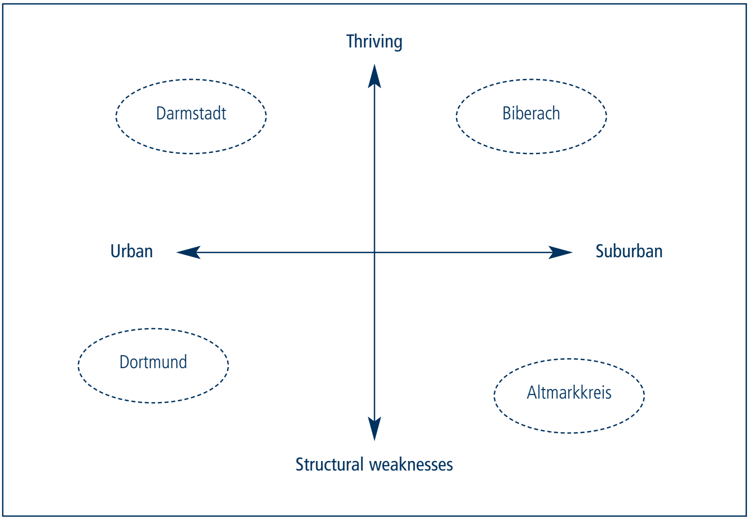
The analysis is centred on the following questions:

- Do savings banks have regional or local economic expertise?
- Are savings banks able to link in to public sector strategy or do they follow their own?
- Do they respond appropriately to regional demand for credit? How does regional competition or the lack of it affect the establishment of stable customer-bank relationships and what is the role of new types of financing such as venture capital?
- How do savings banks deal with intraregional concentration processes and how important are branches to urban districts or villages?
- Is collaboration with other savings banks in the region significant?
- What role do savings banks play in implementing current structural policy approaches and developing endogenous potential?
- What are the root causes of a region's structural economic competences?
- Can politics and policy support structural economic competences (i.e. clusters)?
- What are the regional consequences of spread and backwash and how do these take effect?
- What are the development alternatives for regions without significant competitive competences?

It should be noted that this study did not examine whether all savings banks in Germany work for their location and thus actually contribute to location policy. The regional profile is aimed more at illustrating savings banks' theoretical regional development potential as described above. As savings banks' willingness to participate in such a study also affected the choice of examples, it can be assumed that the institutions presented below are to a certain extent model examples and paint a more positive picture than the actual situation deserves. The profile below is not, however, savings banks on their own assessment, for regional players from outside the institutions were also interviewed.

The diagram below classifies the four sample regions along the settlement structure (urban – peripheral) and prosperity (flourishing – structurally weak) axes.

Figure 17: Matrix positioning the four sample regions



Typical cities/districts in which none of the above features were unusually marked were selected for all four fields. Other conditions for selection were that both *Kreissparkassen* and *Stadtsparkassen* [district and city savings banks] participated in the study and that the area had a clear regional identity both within and beyond the region. Geographical spread was considered to the extent that each region is in a different federal state and one region is in eastern Germany (see map below).

Figure 18: Geographical location of the four sample regions

The table below gives a selection of regional and prosperity data on the four regions. More comprehensive information on the individual regions can be found in the appendix (Table I.5).

Table 6: Regional and prosperity indicators for the regions studied

	Region			
Key data	The City of Darmstadt	The City of Dortmund	The District of Biberach	Altmarkkreis Salzwedel District
Inhabitants/km	1133	2102	131	44
Population density compared to German/ state average[41]	4.92 / 3.93	9.12 / 4	0.57 / 0.44	0.19 / 0.344
Type of area[42]	Central town/ City in agglomeration	Central town/ City in agglomeration	Rural district in urban area	Rural district with low population density in rural area
Unemployment rate (2000-2003 in %)/ number in work per 1000 inhabitants 2003	7.8 / 623	14.7 / 326	4.8 / 327	16.2 / 293
Place out of 439 districts/ urban counties[43]	58	245	8	382

Source: BBR 2004, ReDev indicator (see Chap. 6)

The information used in the regional profiles was gathered from data, factual material (e.g. annual reports) and literature and on several visits to the regions. Interviews were held with savings banks representatives and regional players from various different sectors (business development, *Landratsämter* [district administrative authorities]). All data and a list of material and interviews for the individual examples can be found in the appendix.

41 This is the multiplier indicating the extent to which the population density differs from the national or federal state average.

42 The various categories of area were developed by the BBR according to settlement structure and define all districts and urban counties in terms of population density, population size and local/centre function or location.

43 The table gives the place out of all 439 districts and urban counties calculated using the ReDev indicator (see Chap. 6.2.2).

The following sub-chapters present each of the four regions and their savings banks in the light of the questions posed in the chapters above. The findings reached are summarised at the end of each profile; a summary and conclusion for all four regions is set out in Chap. 7.5.

7.1. The City of Darmstadt

Figure 19: The City of Darmstadt

Darmstadt is located in the polycentric Rhine-Main metropolitan area between the centres of Frankfurt to the north and Mannheim to the south. Darmstadt and the surrounding districts form the region of Starkenburg, part of the Rhine-Main area[44].

The region has good internal and external transport links in terms of private travel (motorways) and the rail and air infrastructure (Frankfurt International Airport). Darmstadt's surrounding area is relatively sparsely populated and of great natural beauty.

Darmstadt is known nationwide and in some areas also internationally as a science and technology centre. Specialised knowledge-intensive corporate services shape its economic structure[45]. Income and the proportion of the workforce with higher education qualifications are significantly higher than the national averages.

44 The region includes both the City of Darmstadt and the districts of Darmstadt-Dieburg, Bergstraße, Groß-Gerau and Odenwaldkreis.
45 For this and all regional examples, please see the tables (1.5) in the appendix when no other sources are given.

The city has an extremely positive commuting balance of 451[46]; the resident population (just under 140 000) fell until 2000 but has been on the increase again since 2001. Policy-makers in Darmstadt are aiming to generate further growth and develop new residential areas to meet the rise in demand this will bring. The number of commuters to the city is constantly increasing, a result of a continuing trend towards suburbanisation.

Darmstadt comes 58th out of 439 districts and urban counties according to the ReDev indicator (see Chap. 6). Various rankings in other publications demonstrate that Darmstadt's position as perceived by the media is significantly better than its ReDev rating would suggest.[47] Some doubt may be cast on the reliability of such popular rankings and published rankings often do not agree (Maretzke 2006: 325), however they do nevertheless at least reflect certain perceptions.

7.1.1. The Economy, Employment and Potential

Many areas of the economy in which Darmstadt has particular competences have historic links to the city, indeed their technological roots lie in Darmstadt. The *Technische Universität* (TU) [University of Technology] plays an important role here. Success factors include networks between the individual companies and the highly developed research infrastructure. The following competence fields are particularly important to the location from a business development perspective:

Information technology: Information technology (IT) is the economic mainstay of Darmstadt and the surrounding region. A few major businesses and a large number of small companies represent the sector in the city. Information technology degrees at the TU and the *Fraunhofer Institute for Integrated Publication and Information Systems* and *Secure Information Technology* are key to IT competence. One example of the importance of the TU is Software AG which grew out of a *Technische Universität* initiative in 1969 and now employs a staff of 2 500 around the world.

46 Per 1000 employees at their place of work.

47 Darmstadt comes 6th of 69 cities studied in rankings by the magazine Capital based primarily on improvements in economic performance, purchasing power, population and jobs (Capital 2001). In the Zukunftsatlas [Future Atlas] published by Prognos AG, Darmstadt was in fourth place amongst 439 districts and independent cities in Germany (Prognos AG 2004). Quality of life also appears to be one of Darmstadt's strengths: the city came 7th among 83 major cities assessed in a study by the magazine Focus (Focus 2000).

While the centre of the software cluster may be in Darmstadt, it is not limited to the city boundaries. There are other sites within the Starkenburg region and a form of "Software Road" runs, through Darmstadt and Heidelberg/Walldorf-Wiesloch where SAP has its headquarters.

Biotechnology/Pharmaceutical technology: Companies in the biotechnology and pharmaceutical technology sector play an extremely important role in the region's economy. At the centre of the cluster is Merck - founded over three hundred years ago and, according to local experts, the oldest chemical/pharmaceutical company in the world. Other firms include Degussa-Röhm, the inventor of Plexiglas and a developer and manufacturer of special polymers, and Döhler, the world market leader in fruit juice concentrates.

Fine chemicals, in particular for hair cosmetics, are another important part of the industry. *Goldwell* was sold to the Japanese group *Kao* a few years ago, and its new owners have developed the site into their international *professional hair-care centre* for Europe.

Mechanical and electrical engineering (specialism in mechatronics): Business development sources claim the sector locally has now recovered from wide-scale job losses in mechanical engineering, developing particular strengths in mechatronics thanks to regional IT and electrical engineering competence.

Aerospace and satellite technology: Kolmer from Darmstadt's Business Development Agency (*Wirtschaftsförderung*) calls the aerospace and satellite sector a "location marketing dream". Darmstadt and the European Space Agency (ESA) based there feature on television every time there is a European mission to Mars. Also based in Darmstadt, the *European Organisation for the Exploitation of Meteorological Satellites* (EUMETSAT) is a similarly effective image factor for the location. The Business Development Agency is looking to focus more on this area in the future.

In addition to potential the length of certain specific value chains, the city also has diverse specialist scientific competences in many different scientific disciplines, in particular technological research in the broader sense. Darmstadt's importance as a scientific centre was recognised in 1997 when it was named City of Science (*Wissenschaftsstadt*) by the federal state.

Another of the location's advantages is its good banking infrastructure. Savings banks, according to Michael Kolmer (from the economic development agency), have an important function especially for SMEs and start-ups despite the city's closeness to the financial centre of Frankfurt.

Various disadvantages of agglomeration such as high housing prices and traffic volume have a negative effect on the region. The upcoming withdrawal of American armed forces could be positive for the city's dynamic growth as it will free up large areas of land which will then be available for housing and office developments.

Although the manufacturing industry is no longer a major part of Darmstadt's economy, industrial promotion is a top political priority - this is reflected in the joint industrial political vision of the city authorities and the business association *Unternehmensverband Südhessen e.V.* The objective, Kolmer explains, is to save the few local jobs that remain in this sector, not least as jobs created in the high-tech industry offer only limited options for former manufacturing workers as they require different skills and qualifications.

There are sharp differences in the strength of the economy within the Starkenburg region. Take for example Odenwaldkreis: this district has a significantly lower value added per head than the rest of the region, partly because it is a mitigation area and subject to a wide range of conservation regulations. Michael Kolmer believes the weakness of the Odenwald area goes largely unnoticed because it is part of prosperous southern Hesse, and that Hesse's state government therefore fails to pay enough attention to Odenwald when drafting and implementing structural policy.

7.1.2. Economic Development Strategy/Institutional Involvement

Darmstadt's Business Development Agency only employs a staff of four and it has therefore not yet been possible to pursue an economic development strategy tailored to individual areas of competence. Reorganisation is now set to rectify this: economic development, urban development and an urban development association will in future be combined in one unit which will implement sector and competence-specific strategic economic development policy.

The focus is both on endogenous economic structural competences and establishing a creative milieu. "Key players are of vital importance to the establishment of creative milieus. These are people who work within the area to develop networks, outside the area to promote the location and at the same time personally identify with a city or region." (Kolmer 2004: 26) The TU and the savings banks play a central role in initiating and developing networks and the regular business and sector talks are, Kolmer claims, an important tool in network creation.

Alone, Darmstadt cannot succeed in the group of "global cities", which is why it positions itself in various geographical contexts in partnership with other cities and districts. "Without abandoning core competences, [Darmstadt] seeks alliances beyond political boundaries" (Kolmer 2004: 47). Starkenburg Business Development Agency (*Wirtschaftsförderung Starkenburg*) was set up to deal with the problem of competition with neighbouring districts. Alongside the City of Darmstadt, the association's members also include the districts of Darmstadt-Dieburg, Bergstraße, Groß-Gerau and Odenwaldkreis.

The association is financed by the participating local authorities, the *Sparkasse Darmstadt* [Darmstadt savings bank], *Volksbank Griesheim-Weiterstadt* and *IHK Darmstadt* [Darmstadt Chamber of Industry and Commerce]. Through the Starkenburg Business Development Agency, Darmstadt is also a member of the newly established *International Marketing Region Frankfurt Rhein-Main GmbH*. However, Michael Kolmer sees extending the area yet further – i.e. into the Neckar region – and marketing elsewhere in Germany and abroad as important goals for the future.

7.1.3. *Sparkasse Darmstadt* (Darmstadt Savings Bank)

In proportion to its total assets, *Sparkasse Darmstadt* grants relatively little credit. This, according to the savings bank, is due primarily to the strong service sector focus in Darmstadt. IT companies and corporate service providers in particular have relatively little need for investment, whilst the major production companies generally have other sources of finance; proximity to Frankfurt, the finance centre, is also significant. *Sparkasse Darmstadt's* income from commissions is however higher than the average as a result of great involvement in the insurance business.

The savings bank does not pursue a specialisation strategy and sees itself as a market leader in all areas. Over recent years it has succeeded in obtaining greater shares of the market for both retail and commercial customers following private banks' withdrawal from the market.

Market situation and shares

The Rhine-Main region has a strong banking infrastructure. Despite intense competition, *Sparkasse Darmstadt's* market share in the primary bank market is around 38 per cent.

The Postbank, the Citibank and the Badische Beamtenbank as well as major private banks and the local *Volksbanken* have a relatively strong position on the local market. Direct and niche banks (see Chap. 3.4.2) – in some cases based in Frankfurt with branches in the Darmstadt region – are also major players in the price competition for retail customers. Georg Sellner, Chairman of the *Sparkasse Darmstadt* Board of Directors, believes "price will in future play a much greater part in the choice of financial institution" in view of the "growing bargain mentality" and is trying to prepare for this development by ensuring extreme efficiency.

He sees price policy together with savings bank success factors such as quality of consultancy, reliability, personal ties and geographical proximity as the major success factor for the future.

Mergers, branches and concentration in the district

Local authority reorganisation at various stages has meant the *Stadt- und Kreissparkasse Darmstadt* [Darmstadt City and District Savings Bank] operates in both the urban county of Darmstadt and parts of the Darmstadt-Dieburg district. The *Zweckverband-Sparkasse Dieburg* [Dieburg Association Savings Bank] is also based in this district, however the two savings banks divide the business area between them and do not operate in the same places.

Mergers are currently not an economic imperative according to the chairman of the savings bank's Board of Directors, however he sees mergers as both possible and sensible in the long term as the local aspect of the industrial region is becoming less and less important, something also reflected in regional political collaborations.

Sparkasse Darmstadt has set up a central transaction processing centre, *Sparkassen-Dienstleistungszentrum Südhessen GmbH* (SDS), together with four neighbouring savings banks and the *Landesbank Hessen Thüringen* (Helaba) to deal with back office work. A cooperation agreement was also reached between neighbouring savings banks in the autumn of 2004 to divide tasks and responsibilities effectively; the agreement was also aimed at ensuring coordinated and concerted marketing for selected products and services.

Most of the branches make a profit and so the branch network would remain even without the public service obligation.[48] *Sparkasse Darmstadt* believes that branches are an important focal point for the local economy, and the branches also benefit from busy businesses in the surrounding area.

Regional Development and the Loan Portfolio

Georg Sellner believes that a reliable business policy which includes all customer groups is not only part of the bank's public service obligation but also a factor for success. A business policy which rapidly changes strategy and defines new target groups in the hope of achieving maximum profits – such as that pursued by major banks in the past – is "unutterably stupid", says Sellner. The Chairman of the Board of Directors stressed that the principle of regionalism forced the bank to achieve optimal market penetration but also meant strength in business development as they had to plan for the long term. Georg Sellner believes business development also means accepting necessary valuation adjustments in lending and nevertheless continuing to work with the customer in question. Despite his clear support for the principle of regionalism, he also sees proprietary trading (securities transactions with the bank's own money) as a legitimate and necessary way to protect the bank from regional fluctuations and diversify its loan portfolio.

48 One branch was closed in the Eberstadt district of the city, however this was connected to the renovation and extension of another branch only 800 metres away and was thus, according to the Sparkasse, an isolated case and by no means the start of widespread branch closure.

There has, according to the Darmstadt Business Development Agency, been a large-scale withdrawal from the SME lending business on the part of private banks in the area and both the savings bank and the cooperative banks have to a certain extent filled this gap. The savings bank's credit structure basically corresponds to the region's economic structure, although the savings bank does claim not to be affected by the concentration risks which pose a particular danger for regional banks (see Chap. 5).

Sparkasse Darmstadt brokers capital via Helaba and the *Bürgschaftsbank Hessen* instead of itself offering companies venture or risk capital, although Michael Kolmer from the Business Development Agency suspects that regional financial intermediaries which provide venture capital will in future become more important, including for the Darmstadt area.

Kolmer appeared extremely happy with the work of the savings bank, in particular with its support for location policy. He could envisage the savings bank extending its intermediary function between the public and private sector in future and operating in other areas, for example location marketing, so that more strategic use could be made of the bank's specific knowledge of the local economy when deciding on business development policy.

Commitment to the region

Sparkasse Darmstadt demonstrates regional commitment at two levels. On the one hand, it encourages its employees' personal involvement in charitable organisations as a symbol of emotional and physical proximity to the location; on the other, it has in recent years spent an annual total of between €900 000 and around €1.1 million on supporting charity projects in the region. This is clearly communicated in the local press. "We belong to the people" is the bank's message according to the savings bank marketing expert, Peter Lehr. The bank's strategy is to distribute funds widely rather than concentrating on a few beacon projects: it makes between 700 and 800 individual donations each year. All projects and organisations supported must be of regional importance; nearly all applications for funding are accepted but often not for the full amount.

In addition to individual donations the bank also funds a cultural foundation and the Ludwig-Metzger-Preis which help improve quality of life in the region. The latter is an annual award to charitable foundations and institutions funded by money from the customer lottery *PS-Lossparen*. The bank also makes an annual payment to the City of Darmstadt for use exclusively in charitable projects.

7.1.4. Findings

The following key findings of the regional analysis above are significant for this study:

Firstly, the example shows that even savings banks operating in flourishing urban regions in intense competition with private banks fulfil an important function in the SME finance sector, and that this role has increased as private banks withdraw from SME finance.

Secondly, local business development policy clearly has much in common with the savings bank's funding and support strategy. Until recently, neither the urban Business Development Agency nor the local savings bank was in favour of direct support for clusters: the two have a common strategic approach arising from informal networks and contacts. It is however noticeable that the savings bank indirectly promotes cluster development by funding individual projects and supporting networks and collaborations.

Thirdly, the example demonstrates the path dependence of regional development and the importance of regional competences' historic roots, for one of the reasons behind the region's success is that scientific and technological competences have developed over time and constantly adapted in line with available competences.

In this context, it is **fourthly** also clear that clusters can be successful even when not specifically supported by public players: it is enough for the public sector to support networks.

Fifthly, the example shows that the local Business Development Agency – which in Darmstadt has to date had a staff of just four – must not necessarily be the central player in regional development. The President of the TU, for example, plays an important role in networks between the relevant players. Such regional involvement is particularly successful in a city or region with a strong and distinctive identity.

The **seventh** point to note is the city's positioning in different spatial contexts. Darmstadt has its own specific image defined by its economic and settlement structure. However, the city needs to operate in different spatial contexts, collaborating with the relevant regional players, if it is to position itself at a national and global level and foster its regional economic links.

That is why the city and surrounding districts established the Business Development Agency for the Starkenburg region, of which Darmstadt is the urban centre. For international location marketing, Darmstadt comes under the Rhine-Main region with Frankfurt at its centre. Future plans are to raise the profile of the "Rhine-Main-Neckar" region so that the area to the south of Darmstadt, which also has close economic structural ties to the city, is not neglected. Darmstadt sees itself here as the link between the polycentric Rhine-Main and Rhine-Neckar regions (Benz 2004: 8).

The **seventh** key finding is that agglomeration problems such as a large volume of commuter traffic and high living costs can arise even in centres which are not on a metropolitan scale.

The **eighth** and final point concerns development in the Odenwald area. This clearly demonstrates that although restrictive nature conservation regulations may halt economic development, they can bring social, ecological and even economic benefits for the region as a whole. However, this requires a cross-regional consensus acceptable to the Odenwald region.

For example, the economic function of Odenwald might be restricted to that of an ecological mitigation area but the region then entitled to appropriate compensation for this. Such a spatial division of roles presupposes that planning and regional structural policy cease striving for equal economic development in all parts of the region (see the distinction between development and service provision strategy highlighted in Chap. 2).

7.2. The City of Dortmund

Figure 20: The City of Dortmund

Dortmund has a population of around 590 000 and is one of the ten largest cities in Germany. Located at the eastern edge of the Ruhr area, the city acts as a key centre for the region of Westphalia. Population density is high at around 2 100 inhabitants per km² but varies considerably within the metropolitan area. The size of this area is an advantage for the city as, unlike in other cities in the Ruhr, a certain amount of suburbanisation can take place within Dortmund itself.

Dortmund has extremely good links to the surrounding area in terms of both private travel (motorways) and rail and boat good transport (inland port), indeed it is a rail and road hub. Recent years have also seen an increase in traffic at Dortmund's regional airport.

Dortmund, like so many other towns in the Ruhr, owes its industrialisation and expansion to the once rich coal deposits which drove the development of the local steel industry. Beer production was the third mainstay of the city's economy until the 1970s and employed around 6 800 people in the mid-1960s.[49]

The decline of the mining and steel industry brought widespread job losses while improvements in productivity also led the brewing and drinks industry to cut jobs in the area. Job losses in the manufacturing industry in Dortmund over the last 25 years were around three times higher than the national average, although they were in part offset by new jobs in the retail and service sectors (Bömer 2005: 8ff, Bade/Kiehl 2002: 30).

49 http://www.wdr.de/themen/wirtschaft/wirtschaftsbranche/brauereien/index_050201.jhtml?rubrikenstyle=wirtschaft

Dortmund comes 245th out of 439 according the ReDev indicator (see Chap. 6). This is a poor result for a western German city considering that places 246 and below are all occupied by eastern German districts and urban counties. Dortmund enjoys a good image because its location policy has for years concentrated on competence fields, and this is reflected in various popular rankings. For example, the former industrial town made it to 28th place out of 60 in the Capital magazine rankings in early 2005 (Capital: 18), while the *Handelsblatt* newspaper (21 July 2004) even went so far as to call the city an "unsung star", writing that "few other cities in the Ruhr have coped so well with structural change".

7.2.1. The Economy, Employment and Potential

Despite the wide-scale job losses in the secondary sector and a lack of sufficient growth in the service industry, Dortmund nevertheless has a relatively strong sectoral structure thanks to the particular advantages of the location. Its more or less isolated position at the eastern edge of the Ruhr enables particularly strong growth in the retail sector, while the Technische Universität (University of Technology) and integrated technology park, various research institutes and business incubation and development centres also play an important role. Current competences have in some cases developed out of historic economic structures. Dortmund has for some years also been pursuing a specific competence policy which focuses on the following sectors which are concentrated in the area:

Information technology (IT): Dortmund is one of the largest IT locations in Germany with around 650 IT companies. The *Technische Universität* with its IT degree course, various institutes and the *Fachhochschule* (University of Applied Sciences and Arts) provide important potential in this sector. The centre of the Dortmund IT cluster developed in and around the universities in the 1970s and 80s in the field of application software. Traditional sectors such as the mechanical engineering and mining industry and their suppliers were also important in fuelling demand (Rehfeld/Wompel 1999).

Microsystems engineering: This new multidisciplinary sector has experienced strong and rapid growth in Dortmund. Around 1 700 people currently work in the 24 microsystems engineering companies in the area according to information from Dortmund's local authority. Important location factors for microsystems engineering in Dortmund include the *Technische Universität* and *Fachhochschule* which offer a range of science and engineering courses in micro-technology, nanostructures and applied microelectronics.

Logistics: The road and rail hubs, Dortmund Airport, the inland port on the Dortmund-Ems Canal, operative logistics with a large number of transsshipment and handling centres and local IT competence all offer great potential for the logistics industry. On top of this is the research potential: various disciplines and chairs at the *Technische Universität* work directly or indirectly on logistics; Dortmund is also home to the Fraunhofer Institute for Material Flow and Logistics. The logistics sector in Dortmund has for years been a growth industry, albeit to varying degrees, and is important to the city not least because operative logistics at least can create jobs for the less qualified. Growth potential in the logistics sector is however limited as it is already highly concentrated throughout greater Dortmund.

The various areas of competence have developed in different ways and to differing degrees. The logistics sector has consolidated in the area and is posting ever increasing turnover; there has been a clear increase in microsystems engineering jobs in comparative terms, however in absolute terms the figure is not significant. The IT industry is still a relatively new sector and as such constantly restructuring. Thomas Ellerkamp, Deputy Head of the Business Development Agency, reports that some companies founded in Dortmund just a few years ago are now being bought up by larger firms and integrated into the new parent companies' sites, so the Dortmund area is experiencing some backwash effects.

Despite positive development in the various key competency areas this has by no means made up for job losses in the industrial sector. This is compounded by the fact that the new jobs, for example in software development or microsystems engineering, have such different specifications that they are not a suitable substitute for the jobs which have been lost. What is more, social segregation within the city is worsening as the various districts are not benefiting equally from economic restructuring.[50]

7.2.2. Economic Development Strategy/Institutional Involvement

Since the late 1990s, Dortmund has been focussing on the development of the three sectors or competence areas already outlined. Dortmund's Business Development Agency claims that despite some criticism[51] there has always been and still is a *broad consensus* between companies and public sector players. Representatives of the local savings bank and of the Dortmund Business Development Agency see this *Dortmund consensus* as an important factor behind the renewed economic optimism. All agree that it required a certain openness, and a willingness to engage in dialogue and communication to enable all players to learn together in networks.

The key element of cluster development strategy, the *dortmund-project*, was set up in the year 2000. The project was launched by the City of Dortmund in collaboration with ThyssenKrupp AG and management consultants McKinsey & Company. Job losses resulting from the merger of Thyssen and Krupp and the company's promise to create replacement jobs in Dortmund were behind the involvement of Thyssen-Krupp AG, which also contributed financially to the scheme. The dortmund-project was integrated into the Business Development Agency in the course of restructuring in 2005 but the name was retained.

50 In an effort to combat economic segregation within the city, the City of Dortmund is participating in the European funding programme URBAN for the *Nordstadt* district, where unemployment is 10 per cent higher than the city average. URBAN is an EU Community initiative set up in 1994 to support particularly depressed urban districts.

51 One criticism is that the city is still suffering from the consequences of having concentrated on too few sectors (coal and steel) and should not expose itself to the same danger again by once more concentrating on just a few business areas.

In an effort to avoid too narrow a focus and remain open to new developments, Dortmund's Business Development Agency is currently promoting other sunrise industries in the area alongside the three competence fields discussed above. However, as these sunrise industries are not currently strong in Dortmund compared to other regions they are not being communicated as competence fields at a national or interregional level.

The Business Development Agency is able to operate on the scale outlined not least because it is well-resourced and has a large staff (approx. 70 employees). This in turn is partly due to a high level of federal state and EU funding (Objective 2 region) and is also a result of Dortmund's professionalism in project applications and project management.

7.2.3. *Stadtsparkasse Dortmund* [Dortmund Savings Bank]

The savings bank's business is similar to that of a typical city savings bank and the bank itself has closely followed and reflects the region's structural transformation. *Sparkasse Dortmund's* main area of business is customer deposits and, like *Sparkasse Darmstadt* (see Chap. 7.1.3), the bank compensates for the size of its relatively small lending business with disproportionately high income on charges and commissions. The savings bank's business development is stable and "in overall terms satisfactory, despite the general economic environment" was the view of the *Sparkasse Dortmund* experts when interviewed. Its large financing commitments as part of cluster and technology policy will, the savings bank believes, have positive effects in the long term; however in the short to medium term certain valuation adjustments have apparently been necessary. As the economic environment in a region affects earnings – this was the view of those interviewed – efforts are being made to improve regional conditions by closely and clearly supporting the city in its process of structural change.

The newly restructured business customer department is divided into specific fields: the trades, commerce, new technologies and the self-employed and this form is designed to reflect structural change in the city's economy.

Market situation and shares

The savings bank has a nearly 60 per cent share of the primary bank market and has been able to extend its share of the business customer market as major private banks have withdrawn from corporate finance in recent years. Dortmund's two cooperative banks are the savings bank's main competitors owing to their similar business focus. Increasing competition is also posed by internet banks and so-called direct banks which only offer certain specific banking services. The Postbank is apparently also a serious competitor in the retail customer segment.

Mergers, branches and concentration within the city

There are currently no mergers planned although bank sources claim that some form of *Ruhr savings bank* at some point in future would not be inconceivable. The savings bank believes that whilst mergers do bring savings through the creation of economies of scale, they are not the answer to all its problems. If the business areas become too large, this poses two risks. Firstly, market knowledge may be lost, and secondly, the banks may start to concentrate solely on the highly promising economic locations within their business area. Those interviewed believed that some of the advantages of a merger could also be achieved by (regional) cooperation for back office work; however there is (as yet) no regional processing company in the the wider region.

Sparkasse Dortmund has made fundamental changes to its branch concept based largely on the DSGV's *Vertriebskonzept 2010* [Sales Concept 2010][52] in the course of which many aspects of branch business have been automated; cash is for example now available almost exclusively from cash machines. Customer service advisors have as far as possible been relieved of routine duties to allow them to work more in consultancy and sales and expert specialist consultancy services have been concentrated at the head office and just a few branches. No branches have, however, been closed.

52 The 2010 strategy is that everyday business in normal branch offices is processed as far as possible automatically and that the branches concentrate more intensively on wealthy retail customers. Specialist customer service agents outside the branches will be responsible for corporate customers. At the same time, new branches are to be opened in shopping centres.

Regional Development and the Loan Portfolio

The savings bank plays an important role in SME finance according to Thomas Ellerkamp from the Dortmund Business Development Agency. Private banks, says Ellerkamp, tend to withdraw rapidly as soon as there is a liquidity problem, for they lack a close understanding of their customers' mentality and are thus unable to judge a company's situation so well. Moreover, their local branches have only limited decision-making power and must first obtain approval from the head office – which is even less able to assess the local situation. The Business Development Agency works closely with the savings bank and cooperative banks in case of equity squeeze off of regional corporations. The savings bank itself apparently has a network of management consultancy firms etc. which are called into action when companies fall into financial difficulties.

Ellerkamp claims that private banks are not only less involved in recapitalisation but have in recent years increasingly withdrawn from the credit business in the SME finance sector in general. The *Volksbanken* also play an important role but are, according to Ellerkamp, traditionally more involved in the trades. He sees the savings bank as "the key player in the location's development" and believes privatisation would have catastrophic consequences for the location in the medium to long term.

Although the savings bank is also involved in corporate finance in Dortmund's competence fields, it claims not to be exposed to concentration risks (see Chap. 5.1) as the clusters themselves are apparently functionally diverse and cover various different sectors.

Capital is an important factor in driving forward sector development and there was a lack of risk capital options in Dortmund. The savings bank therefore set up a risk fund in 1999 with a starting capital of €15 million, a move warmly welcomed by the city's economic players. In setting up *SparkassenVentureCapital Dortmund GmbH* (SVC), a full subsidiary, the savings bank was seeking to minimise risk but nevertheless become involved in the area's development while also generating profits. The fund holds minority stakes totalling between €100 000 and €1 million in companies throughout greater Dortmund. A smaller holding would in the view of SVC Managing Director Gerhard Steinkamp not be worthwhile.

Specialised funds are generally involved to minimise risk and contribute know-how, for example on market prospects for particular product innovations. The fund also draws on expertise from consultancy firms, in particular for start-ups in the high-tech sector, and efforts are made to secure the fund's holdings through guarantees from the federal state. The SVC closely advises the companies it has provided with venture capital. It is, according to Steinkamp, as yet impossible to predict the economic success of the fund as stakes take six to seven years to pay off.

Both Gerhard Steinkamp from the SVC and Thomas Ellerkamp from the Business Development Agency see a lack in the *seed financing* sector[53] for which even the SVC cannot compensate for alone as the segment is a high risk one.

The local savings bank, the *NRW.Bank* (a promotion bank of the federal state) and the *Schüchtermann-Schillerschen Familienstiftung* (a regional charity) therefore set up the fund *Seed Capital Dortmund Fonds* in early 2006 with a starting capital of €10 million.

Alongside its role as lender and investor, says Dieter Steemann, also from the Business Development Agency, the savings bank has an important function in establishing networks and implementing and financing projects. The savings bank is, for example, involved in the sector-specific Dortmund start-up competition *start2grow*, coaching participants, helping with business plans and sitting on the jury. By its own account the savings bank is of course also hoping to acquire new customers who will in a few years' time be profitable ones, for – and this is a point on which all interviewees from the local savings banks agreed – high credit check costs and high risks mean start-up financing only becomes profitable once the start-ups are well-established companies which still have a business relationship with the savings bank. The general consensus was that the risk of these customers moving to other banks once established is currently fairly low as major private banks are not very active in this business area (free rider problem, see Chap. 1.3.2).

53 Seed financing is finance for innovations or business ideas which are not yet ready for the market and which therefore usually do not yet have a business plan. Start-up financing as such follows seed financing.

Commitment to the region

The *Sparkasse Dortmund* works for the region at two levels in addition to its function as financial intermediary. On the one hand, it tries to raise staff awareness that they work for a bank committed to the public interest and encourages them to make a contribution to and for the region. On the other hand, the *Sparkasse Dortmund* commits both personnel and financial resources to many different projects and has invested several million euros in two charitable foundations. Donations and investments are by the bank's own account aimed at achieving the greatest possible benefits for the region, although in sponsoring in particular effective publicity for the savings bank is also important. Charitable spending has fallen slightly in recent years as a result of the drop in profits. It amounted to around €1.26 million in 2004 plus approx. €67 000 awarded by the foundations. An annual payment is made to the city authority which, in accordance with the *Sparkassengesetz des Landes NRW* [North-Rhine Westphalia Savings Bank Act], must be spent on charity work.

7.2.4. Findings

An overall assessment of the profile above raises the following points of relevance to this study:

Firstly, the example also shows that savings banks are able to adapt to municipal business development strategy. The *Sparkasse Dortmund* is involved in the development of endogenous competence fields, has in part defined its structure in line with this strategy and has in-depth knowledge of competence field policy and regional economics.

Secondly, it should be noted that savings banks to a certain extent also adapt their financing products to meet local requirements. Some examples of this include the savings bank's risk fund, created following a request by the public authorities, and the new venture capital fund designed to improve available seed financing options.

Thirdly, the example demonstrates the importance of regionally-oriented credit institutions able to assess a company's position in terms of the regional value chain. This function has become more important in Dortmund following the withdrawal of private banks and is vital in solving SME cash flow problems. To return to new banking theory (see Chap. 1.3.2), it becomes clear just how far geographical proximity can reduce information asymmetries and thus affect banks' willingness to lend.

A **fourth** interesting point is the view of the savings bank's staff that start-up financing only becomes profitable in the long term, and that investing in information in less competitive markets can be an advantage as there is a lower risk of competitors *stealing* these customers once they are established.

Fifthly, it is clear that the driving force behind the savings bank's commitment to the regional economy does not always come from the bank itself. For example, the start-up network in which the savings bank plays a key role was launched on the initiative of the dortmund-project.

Such a procedure can of course only work – and this is the **sixth** finding – if regional stakeholders have reached a general consensus on the development of the region. Such a *governance structure* is therefore one of the prerequisites for successful location development.

The **seventh** point is that economic development is clearly only moderate notwithstanding the *Dortmund consensus* and the area's relative strength as a business location. However, this does not mean that business development measures are ineffective, but rather that their effect should not be overestimated; that it is not possible to act in direct opposition to prevailing trends and that regional economic development is usually path-dependent.

Point number **eight**: this example also shows that even an old industrial city badly affected by structural change and devoid of architectural or cultural attractions can nevertheless create a positive image. Moreover, it is clear that endogenous strengths are not the only important aspect when implementing projects and obtaining public financial support: public sector players' ability to make use of suitable funding programmes is also important. Yet this does not mean that all cities affected by structural change are always able to react in a similar way, for Dortmund's very geographical position at the edge of the Ruhr area offers particularly good options for dealing with structural change.

The **ninth** point is that an apparently successful competence field policy has in fact had relatively little effect in terms of the number of jobs. It is therefore by no means a viable option for creating sufficient new employment to compensate for job losses in the industrial sector. It is also clear that a focus on individual sectors or competence fields is a politically difficult course to maintain.

Finally, it can therefore be **concluded** that whilst a region such as Dortmund may have no alternative to the competence field approach, such an approach alone can neither be the sole aspect of local economic strategy nor applied to all regions as a universal concept.

7.3. The District of Biberach

Figure 21: The District of Biberach

The district of Biberach is part of the region of Upper Swabia and lies between Stuttgart, Munich and Zurich (or Lake Constance). Its population of around 185 000 is spread across 45 municipalities and an area of 1 410 km². The population density, 131 inhabitants per km², is only half as high as the Baden-Württemberg average but continuing growth in the population and on the employment market are now leading to an increase in both population density and urbanisation. Other rural districts experiencing similar growth tend to be situated in the exurbs of successful agglomerations and benefit from suburbanisation. The district of Biberach, however, has its own economic base, in particular in the export-oriented commercial sector, and this is what is driving its development.

Biberach comes 8th of 439 districts and urban counties according to the ReDev indicator. The complete area covered by the IHK Ulm [Chamber of Industry and Commerce] – to which the district of Biberach belongs – does extremely well in many business location rankings and comes top in various categories in the online survey *Perspektive Deutschland* (IHK Ulm 2005).[54]

7.3.1. The Economy, Employment and Potential

Economic development in "the late starter, Upper Swabia" (Schneider/ Weigele 2003: 5) did not get underway until after the Second World War and was triggered partly by the arrival of pharmaceutical company *Boehringer Ingelheim Pharma KG*[55] in the 1970s. Famous for biopharmaceutical products, the firm now employs a staff of nearly 4 000 at its Biberach site. Other pharmaceutical companies came to the region in the wake of Boehringer Ingelheim, and the medical technology sector also grew thanks to contacts with the many skilled local tradesmen and small businesses – many of these acted as specialist suppliers. Pharmacy and medical and biotechnology are now amongst the strengths used to market the region of Upper Swabia.

The *IHK Ulm* area is one of the 26 regions in Germany which bear the *BioRegio* label. Regions operating under this label have particular competences in the biotechnology sector, network regional players and market their area accordingly. Important structural economic bases which justify BioRegio positioning are concentrated in Biberach,[56] however according to Wolfram Blüml, *leitender Regierungsdirektor* [chief government official] in Biberach, the district was not the driving force behind the regional BioRegio initiative: the scheme was spearheaded by the Region of Ulm. The district savings bank is supporting the development of biotechnology competency by financing a chair for the newly established *pharmaceutical biotechnology* degree programme at the Biberach University of Applied Sciences.

54 Biberach beats the surrounding districts: the district came 12th in a study by Focus-Money which classified urban districts by investment in commerce, unemployment rates, value added per person in work, net migration and numbers in work (Focus-Money 2004). The neighbouring district of Sigmaringen only came 323rd in the Focus-Money study. There was a similarly extreme difference between the two districts in the increase in local employment from 2002 to 2003: Biberach came top in Baden-Württemberg while Sigmaringen was third from the bottom (Statistisches Landesamt Baden-Württemberg [Baden-Württemberg State Office of Statistics] 2005).

55 Formerly Thomae.

56 The district is home to a plant for large-scale manufacture of biopharmaceutical products constructed in 2003 with an investment of €255 million from Boehringer Ingelheim.

Information provided by the district authorities suggests that Biberach also has strengths in the construction machinery, tool construction and metalwork sectors alongside biotechnology, medical technology and the pharmaceutical industry. Tourism does not play a significant role in the local economic structure although living standards in the region are high, for other regions such as the Allgäu are apparently better established.

The University of Applied Science, that offers degree courses in economics and construction, has to date had no decisive influence on regional development. Those interviewed, however, expect this to change with the launch of the new degree in *pharmaceutical biotechnology*. Proximity to the university town of Ulm, according to the then Chairman of the Board of Directors[57] at the district savings bank, Otmar Weigele, is only significant in the field of basic research and direct cooperation between companies and universities is fairly rare.

Around 45 per cent of those in work and paying social security are employed in the production industry. While this is an unusually high figure for a prosperous region, it is one of the factors in Biberach's success as industry in the district is focussed largely on the export trade.

Not all parts of the area are benefiting equally from its growth. Economic development in some of the district's municipalities (e.g. Riedlingen) is considerable weaker and both the economy and the population in certain areas have shrunk or are shrinking. The weaker areas in the district tend to be peripheral and transport links insufficient, indeed the transport infrastructure as a whole is one of the district's weaknesses: there are neither direct road, rail nor air links to the main transport routes.

7.3.2. Economic Development Strategy/Institutional Involvement

One of the many responsibilities of *stellvertretender Landrat* [deputy leader of the district authority] Wolfram Blüml is the economy, and he is supported in this role by an administrator. The district focuses less on economic development or cluster strategies than direct contact with companies. Blüml has been working in the district for over 30 years and thus has close contacts with the administrative and local authorities. Obtaining authorisation or approval is therefore an extremely rapid and uncomplicated process.

57 Dr. Otmar Weigele, Chairman of the Board of Directors at the Sparkasse Biberach, left the organisation during the period of the study. This had no effect on continuing discussions and the views at the savings bank.

The city Biberach is the only place in the district Biberach with a town Business Development Agency, however the member of staff who works there also has other responsibilities. There are thus overall few resources available for business development in the Biberach district.

No business location or regional marketing is done by the district. IHK Ulm believes the failure to use the region's clear competence profile in national and international marketing is a result of the Swabian mentality. Communicating successes is not popular in Swabia, or as the Spokesman of the Board of Directors Wolfgang Schmitt put it, "*nicht geschimpft ist gelobt*" ("silence is praise").

7.3.3. *Kreissparkasse Biberach* [Biberach District Savings Bank]

The does engage in the typical business of a rural regional bank but the proportion of proprietary trading (securities trading on its own account) on its balance sheet is unusually high, exceeding profits from retail banking. There are various reasons for this. Firstly, the savings bank has enough liquid funds at its disposal and, it claims, the necessary know-how for investment banking without the need for external experts.

Secondly, the savings bank has already exhausted sensible economic growth in the region as further growth through larger shares of the regional market could only be generated by a stiff price competition. Thirdly, the investments help reduce risk. Regional banks, according to Otmar Weigele, are frequently exposed to concentration risks due to local economic structures often built around just one or very few sectors. Investments outside the region therefore help *counter risk* and diversify the portfolio. Fourthly, the additional earnings make it possible to provide even greater support for the region. The effect of investment banking is therefore, Weigele claims, similar to the "import of capital stock to the provinces".[58]

58 Sparkasse Biberach believes this strategy cannot be applied unconditionally to other savings banks as it requires capital and know-how and investment banking also brings risks.

The *Kreissparkasse Biberach* generates higher than average profits and both the interest surplus and profits have risen continuously over the past few years. Increased interest and commissions margins led to a significant fall in 2004 in the cost-income ratio (CIR), the measurement of operating efficiency. As the *Leiter des Vorstandssekretariat* [Head of the Executive Secretariat] Georg Stickel explained, return on equity has for years remained comfortably above the 20 per cent mark despite the bank's strong equity base, amounting to around 25 per cent in 2004.

Market situation and shares

Kreissparkasse Biberach has a share of around 38.2 per cent of the local primary bank market. Competition in the district is shaped by the 14 cooperative banks operating in the area which have a market share of approx. 50 per cent in the retail banking sector. Traditionally, most small trades and agricultural businesses are customers of the cooperative banks. Large-scale farmers, public servants and larger commercial businesses tend on the other hand to have their main bank account at the savings bank. The private commercial banks which compete with the savings bank above all in the *major international customers* segment play only a minor role in the district of Biberach.

The bank's customer ties to the district and the municipalities within it are extremely close. This is true not only for the classic *Kassenkredit* (ways and means advances) which provides the town with funds at short notice, but also public-private partnership models. For example, the savings bank founded a subsidiary which purchased an unoccupied building in the town centre, renovated it and leased to the *Landratsamt* [district administrative authority].

Mergers, branches and concentration in the district

Mergers are neither planned nor necessary from either a banking or structural economic perspective according to those interviewed.

The district savings bank has 40 branches and has no plans to withdraw even from those municipalities in the district with declining populations. It invests as much in branch modernisation in these areas as elsewhere.

Unlike other savings banks, the *Sparkasse Biberach* has no plans to set up joint processing companies to deal with back office work more efficiently (see details on the *Sparkasse Darmstadt* in Chap. 7.1.3). First of all, the bank claims, the district savings bank aims to provide jobs for the less qualified in the region in the long term too, even if this means failing to use rationalisation potential. Secondly, as all those interviewed at the *Sparkasse Biberach* agreed, banks' potential to save is overestimated.

A good cost-income ratio should be achieved primarily by increasing income. Whilst bank personnel were of the opinion that savings banks cannot neglect cost issues, they believed that cost reductions alone would not be enough to deal with increasing competition on the banking market. *Kreissparkasse Biberach* is therefore focussing more on quality and creating value for the region, which means it aims to provide better customer support and offer further financial services as part of an "Allfinanz" [comprehensive financial services] strategy. Those interviewed could also see the savings bank offering non-banking services in future provided these were connected to the region.

Regional Development and the Loan Portfolio

The *stellvertretender Landrat* claimed the savings bank is a particularly important lender for growing companies not listed on the capital market and that this function has become even more significant in recent years as the private banks withdraw from the SME segment.

One organisation with a key role in the regional economy is the *Sparkassen-Chancenkapital BC*, a full subsidiary of the *Kreissparkasse Biberach*, which has been providing companies in the region with venture capital since 1999. There is some cooperation with the neighbouring *Kreissparkasse Sigmaringen* to the west: *Kreissparkasse Sigmaringen* does not have its own investment company so Biberach's savings bank processes investments[59] for companies in Sigmaringen. The aim of the investment company is both to generate profits and to support the regional economy. This comes in the context of a chronic lack of equity in the SME sector which, in the wake of Basel II, is increasing the costs of financing. The use of capital similar to equity improves companies' credit ratings and this in turn reduces financing costs.

59 Both risk and profits are borne/received by the Sparkasse Sigmaringen.

The savings bank is also aiming to enable organic growth for listed family-run companies, avoid forced takeovers by major international groups and thus protect jobs in the region. On the information of savings bank staff, the approx. 50 stakes held are already bringing in profits although the company has only been operating for around five years. The investment company also works with start-up firms as well as financing investments in expansion, and not only provides venture capital but also supports the businesses in economic and planning issues.

Commitment to the region

Private banks have a duty to their shareholders in the form of return on investments. In a similar way, all savings banks including the *Kreissparkasse Biberach* have a duty to society in the region under which they operate. *Kreissparkasse Biberach* presents its funding commitments extremely transparently to prove that it is fulfilling its public service obligation. It sets out its regional economic commitments in a *Gesellschaftsbilanz* ("social balance sheet") and posted a *Gesellschaftsdividende* ("social dividend") of around €4 million for the 2004 financial year, twice as much as the previous year.

This sum includes both awards made out of the foundation capital of the savings bank's own two foundations, additional capital paid in to the two foundations and general charity donations and investments made by the savings bank. Sponsoring expenses are not included.

Funding commitments are not limited to socio-cultural issues; they also cover regional development. For example, the bank for a time funded a chair for the new *pharmaceutical biotechnology* programme at the University of Applied Sciences of Biberach to increase regional competence in the field of biotechnology, and the energy agency and tourist office also received financial support.

The savings bank awards funding for charitable work and its foundation on a selective basis as it receives a large number of applications. The key selection criterion is achieving the greatest possible benefit for the public. The savings bank also attempts to retain a regional balance, as most of the applications come from the town of Biberach and there is thus a danger that it neglect the surrounding area. No payments are made to the local authority body responsible.

7.3.4. Findings

The region of Biberach as it relates to the local district savings bank is significant to this study for the following eight reasons:

Firstly, the savings bank's large investment banking commitments. Savings banks pursuing this strategy to a certain extent cease to be reliant on regional development and can thus diversify their risk structure. It is true that they thus in part evade the rule that capital earned in the region should be returned to the region in the form of loans, yet such an approach can be a sensible strategy for savings banks with available capital, i.e. which have already met the regional lending demand, although it naturally also poses certain risks.

Secondly, the example demonstrates the important function of regional banks in the provision of venture capital, particularly in a region with a high proportion of family-run companies whose low equity base and size make financing on the capital market difficult if not impossible.

This shows that capital market-based finance in which companies sell stakes instead of taking out loans (see Chap. 1.3.1) is becoming increasingly important and to a certain extent superseding bank loans. This is important to savings banks for two reasons: firstly, they must respond to the trend on purely pragmatic business grounds and, secondly, they must use venture capital to build up long-term relationships with companies.

Thirdly, the savings bank is a model example of transparent communication as regards its charitable and social involvement and public service obligation. It uses relatively clear criteria to calculate and present how much money goes to the district, and the term *Gesellschaftsdividende* (social dividend) highlights the specific legal form and the savings bank's obligations.

Fourthly, it is interesting that cost savings and efficiency in processes are not this savings bank's main objective. The district savings bank sees returns as more important than costs even in the light of expected increases in competition. It believes that overly intense cost competition damages quality and this does not fit with the savings bank model.

Fifthly, the region studied illustrates that competitive clusters can develop even in the absence of a deliberate competence field policy. The district may not explicitly pursue strategic economic policy, concentrating instead on company service and reducing bureaucracy, but this does not mean that the regional players are not aware of the area's strengths.

The development of regional competences is now also supported by the local savings bank; this is reflected for example in the savings bank's financial commitment to the new *pharmaceutical biotechnology* course at Biberach University of Applied Sciences.

The region is interesting **sixthly** because its successful development is hard to explain: it does not benefit from proximity to surrounding centres and can therefore develop neither as a residential area nor, with a specialist economic function, as part of an agglomeration. The numbers employed in the service industry, in corporate service provision and with higher education qualifications – usually indicators of regional success – are also below average.

One reason for successful development would appear to be that the region had few key economic bases in the 1960s and 70s. It was thus not confronted with the decline and collapse of certain industries and had production factors available for the development of new sectors.

The district also benefited from the fact that the right sector moved to the area at the right time, namely the *pharmaceutical industry*, although this also illustrates that this was beneficial above all at that time. The sector's healthy development can also be explained by its connections with the traditional small and medium-sized businesses in the region. Such a success would therefore not appear to be possible everywhere, but occur above all when the new sector can draw on existing local business structures and potential.

Seventhly, the region's development demonstrates that economic focuses can in individual cases develop when certain companies move to an area. However, the arrival of these new business players would probably not have been such a resounding success for the region had it happened in today's global economic environment. The factors which determine the success of such a development are complex and extremely hard to establish ex ante.

Eighthly, the example shows that although economic development may produce spatial spread effects (see Chap. 1.2.3) these occur in very different spatial contexts. Companies did relocate to the area but not from the immediate vicinity. Development in weaker parts of the district also shows how slowly positive effects spread even within one district, which according to those interviewed is due above all to poor infrastructural links to weaker areas.

7.4. Altmarkkreis Salzwedel District

Figure 22: Altmarkkreis Salzwedel District

The district of Altmarkkreis Salzwedel is located at the former *border between East and West Germany* in the former GDR. It was created in Saxony-Anhalt's local authority boundary reform in 1994 from the districts of Gardelegen, Klötze, Salzwedel and part of the district of Osterburg. The district covers 2 292 km², an area nearly as large as the federal state of Saarland. It is the most sparsely populated area of Saxony-Anhalt with a total population of around 100 000 and a population density of 44 inhabitants per km².

Although the district is in central Germany, the region could be described as peripheral in terms of the benefits of its location: the state capitals Hanover (approx. 152 km), Hamburg (approx. 134 km), Magdeburg (approx. 100 km) and Schwerin (approx. 108 km) are not far away but the region does not fall within the direct catchment area of any agglomeration or large city. This is compounded by the lack of a good transport infrastructure allowing rapid travel and access to other areas. The nearest motorway is a 54 minute drive away, significantly further than the national German average of 17 minutes.

A trend towards concentration is emerging within the district. Population is declining most and fastest in peripheral parts of the district while companies are moving primarily to the towns of Salzwedel, Gardelegen and Klötze or Kusey. The district town of Salzwedel with a population of approx. 21 500 is a middle order centre.

Population density in the region is already extremely low and emigration has increased relatively sharply in recent years. The *Landrat*, Hans-Jürgen Ostermann, believes one reason for this is that the commuters[60] are now firmly established in their jobs in the neighbouring economic centres and are therefore moving away. This is particularly problematic considering the district only has a very limited economic base and is dependent on income earned elsewhere. Unemployment – 16.2 per cent – is moderately low compared to the federal state average (20 per cent). The ReDev indicators puts the district 382nd out of 439. Many companies have moved to the areas in recent years, but these are for the most part branch operations with few ties to the region.

7.4.1. The Economy, Employment and Potential

A relatively high proportion of those in employment work in the agricultural sector and this shapes the district's economic structure. Industry is underrepresented; service sector employment is in line with the national German average. Most of the service sector jobs are in domestic services which have a high proportion of the whole economy due to the low level of local employment. The number of corporate services is far below the national average.

The district's location meant many inhabitants were employed as border officials prior to German reunification and thus offered no professional qualifications which could have provided a basis for economic development. Production plants were set up to provide jobs for the wives of border guards as part of a directed economic development strategy but these were closed following reunification. Food production businesses and plastic and rubber processing plants in the area underwent a process of spatial concentration after reunification and in many cases relocated, above all to Lower Saxony.

60 The district has a commuting balance of -247 per 1 000 in employment.

The experts interviewed said the district has no relative strengths in the sense of competence field or cluster development, nor is there any historic economic basis. There are nevertheless a few areas with which the region is trying to market itself:

The district does have residential and environmental potential to become a tourist and nature area, this includes in particular the cycle path along the former border. Cooperation with the neighbouring district of Stendal in the tourist association also works extremely well according to the *Landrat*. Tourism in the district nevertheless does not offer enormous development potential as there is a lack of both a sufficient tourist infrastructure, particularly in the café and restaurant trade, and cultural or historic highlights which could improve the region's image. The *Landrat* rates competition with other tourist regions as too intense and the relative benefits of the region as too low for this sector to offer particular growth opportunities.

In the automotive and vehicle construction sector, the region benefits from its proximity to the region of Wolfsburg and the high level of funding the region has to date received as a European structural policy *Objective 1 area*[61]. Efforts are being made to network companies in the two Altmark districts Altmarkkreis Salzwedel and Stendal and strengthen the region's image and reputation in the automotive sector with the *Fahrzeugbau Altmark* initiative. Regional experts explained, however, that it is only possible to involve new companies in the area up to a point as they are often branch operations of major groups which have little interest in the region.

The *Naturstoffinnovationsnetzwerk Altmark* [Altmark Raw Materials Innovation Network] drew on the area's agricultural base to turn the region of Altmark into a technology, production and demonstration centre for renewable resources, but local savings bank representatives, the *Landrat* and the district business development officer rated its success as merely moderate. It has to date resulted in only a few jobs and start-ups and a key hemp processing company is now insolvent. A certain scepticism has emerged amongst farmers who had been persuaded to cultivate renewable crops (in particular hemp) as they cannot rely on steady demand.

61 It is however likely that the EU will in future focus more strongly on available potential in Structural Fund awards and that the region will no longer be able to enjoy this high level of subsidisation (see Chap. 2).

This initiative's lack of success may in part be due to the fact that no specific competences other than agricultural land were available and these had first to be developed with the aid of public funds. New openings are now appearing in the field of renewable resources and biomass for power generation which the district is also exploring, and the sector will doubtless grow over the coming years. Many rural regions nevertheless see it as a sunrise sector and this raises the question of how far all these regions could survive on renewables alone.

The region is poorly positioned in terms of its research structure. There are no public research institutions in the district. Those interviewed said *the Fachhochschule* in the neighbouring district of Stendal had no effect on the rest of the region and Magdeburg very little impact on research.

Businesses are generally merely production sites and the district therefore has only limited research resources even in the private sector. The *Landrat* is afraid that this is driving a cumulative process: knowledge-based sectors cannot become established owing to a lack of qualified locals and local research institutions; the business structure and lack of educational institutions means the workforce cannot become sufficiently qualified. This is reflected in the small numbers of highly qualified people working in the district.

7.4.2. Economic Development Strategy/Institutional Involvement

Business development in Altmarkkreis Salzwedel is managed by the *Innovations- und Gründerzentrum* (IGZ) [Innovation Centre] which also provides office space for start-ups and companies. The managing director of the IGZ Matthias Baumann is supported by the *Landrat*, in particular in attracting companies to the area. The various towns in the district also work on business development for their own area.

There are no efforts to develop specific competences as the district has few competitive strengths in terms of the national market. The district focuses instead on bringing companies to the area without focussing on a specific sector. Regional players see benefits to not pursuing a cluster policy: there is less risk of a downwards spiral in the wake of a crisis in one sector, and it keeps the region open to all companies and fields. A policy of attracting businesses from all industries to the region is aimed creating a *seed bed* from which specific competences can grow in future.

This policy has indeed produced results as the continuous increase in jobs in industry – so scarce before reunification – clearly demonstrates.

In the view of those interviewed it has, however, become more difficult to attract new companies since EU expansion in 2004. The district apparently has no relative infrastructural advantages over the new member states and is neither able nor willing to compete with cheap factor costs in Eastern Europe. The *Landrat* is extremely concerned about the trend in federal state, German and EU politics towards greater support for growth poles as part of a cluster policy and consequently the spatial concentration of public infrastructures (see also Altmark Zeitung 27 April 2005). He believes the federal state should concentrate instead on attracting companies to and industrial development in rural areas.

The *Landrat* hopes that the district will in future benefit from intense decentralisation in the food processing industry as a result of rising energy prices and greater ecological awareness.

7.4.3. *Sparkasse Altmark West* [Altmark West Savings Bank]

Sparkasse Altmark West was restructured following the 1994 local authority area reform. Its business and image are typical of a district savings bank in a rural area but it grants a relatively high number of loans for an eastern German savings bank. The savings banks operates primarily as a true retail bank and engages in relatively little proprietary trading.

Market situation and shares

The savings bank has an approx. 52 per cent share of the main account market. Unusually for a rural peripheral area there is a fairly high level of competition even without the cooperative banks. Seven banks from the cooperative sector and the three major German "AG" banks [joint stock companies] (Deutsche Bank-SB, Dresdner Bank and Commerzbank) all have branches in the area. The VW-Bank, while it does not have branches locally, also poses serious competition; much of the local workforce commutes to the Wolfsburg area and some are employed by VW. The role of internet banks in Altmarkkreis is moreover increasing slightly, in particular in the retail banking business.

The withdrawal of private banks from the SME business in recent years has allowed the savings bank to increase its share of this market segment. By the savings bank's own account, it has also taken on such SME customers in cases where profits and risks were bordering on the unacceptable.

Mergers, branches and concentration in the district

When a savings bank serves a large geographical area – as is the case for the *Sparkasse Altmark West* – there is a danger that it focus on the centres or more populated parts and fail to consider the needs and requirements of what are in some cases extremely peripheral areas. This in turn can intensify regional disparities. *Sparkasse Altmark West* has by its own account solved this problem by employing two area managers in the district and granting considerable powers to local customer advisors.

Mergers are reportedly not an economic necessity, nor are any planned despite many projects and initiatives carried out in cooperation with other districts. An upcoming local authority area reform in Saxony-Anhalt will not affect the districts of Altmarkkreis Salzwedel or Stendal as combining the two would create a district too large to be managed.

Sparkasse Altmark West has closed two branches in recent years, and this slight branch consolidation was also advocated at a political level. Further branch closures are not currently an economic necessity. Interviewees emphasised that the savings bank branches in peripheral areas play an important role as focal points for local service provision and as local meeting places. Institutions such as savings banks appear to be an important factor, albeit insufficient in itself, in ensuring that fragmented local service centres function. This is reflected in the fact that some places have only one savings bank branch left and all other shops have closed.

Regional Development and the Loan Portfolio

Sparkasse Altmark West seeks first and foremost to generate profits through banking services. Loans are only granted if the risks can be calculated and are in line with statutory lending regulations. By its own account the *Sparkasse Altmark West* does, however, also lend when the expected returns do not justify the credit check and transaction costs.

It was pointed out that the credit check costs are lower for savings banks than for private banks thanks to a more detailed knowledge of the customer and that customer proximity therefore constitutes a significant competitive advantage, albeit not the only one which gives the savings bank the information edge. Detailed knowledge of the local economy apparently makes it easier to judge a company's competitiveness in a regional context. The savings bank collaborates with the *Bürgschaftsbank Sachsen-Anhalt GmbH* in company recapitalisation work in order to minimise the risks. It also has a network of management consultants which it calls upon in such cases.

The savings bank collaborates with *Sparkassenbeteiligungsgesellschaft Sachsen-Anhalt mbH* when working with firms whose equity base is weak. This limited company was set up by twelve savings banks from the federal state of Saxony-Anhalt.

In the *Landrat*'s view, the savings bank is vital both to the development of basic economic services and for SME financing in the commercial sector. The situation in the region would be significantly worse were it not for the local savings bank – at least that is the opinion of the *Landrat*.

Credit to borrowers in the building trade, the service sector, the manufacturing industry and retail make up a high proportion of the loan portfolio but there is sufficient risk diversification: according to the savings bank there are no concentration risks and risk swapping is not indicated.

Commitment to the Region

Employees are bound under the guiding principles of the savings bank to make an active commitment to the region. *Sparkasse Altmark West* is involved in a wide range of social and cultural activities over and above its regional economic function. The savings bank's commitment is actively communicated and presented in a charity spending section in the annual report. Overall financial commitments to the region have risen continuously over recent years and amounted to €295 000 in 2004. These include donations, sponsoring, profits from the savers' lottery and funds from the *Ostdeutsche Sparkassenstiftung* foundation which are used in the district. The savings bank has to date been able to respond to every application for support. There have as yet been no payments to the municipal guarantor.

7.4.4. Findings

Both the district of Altmarkkreis Salzwedel and its local savings bank are of interest to this study for the following reasons:

Firstly, the example clearly demonstrates the importance of public banks for peripheral regions. Ensuring the provision of credit keeps the district's economic development options open and maintains its business infrastructure, preventing or reducing the severity of cumulative effects.

Secondly, the savings bank is proof that even savings banks operating in a difficult economic environment can be profitable. This had already been established using statistical analyses in Chapter 6. What is particularly important here is the finding that credit check and transaction costs for loans are lower for savings banks than for branches of major banks as customer proximity gives the former the information edge.

Thirdly, this savings bank also confirms the observation that savings banks adapt to regional strategy and regional potential in their regional economic involvement. Neither the savings bank nor the district authorities focus particularly on the development of competitive clusters.

The example is important **fourthly** as it clearly demonstrates that regions such as the Altmarkkreis do not benefit from competence-based structural policy or spatial concentration, indeed this weakens their economic development. Regional players are therefore calling on the federal state to help attract companies to the district.

Fifthly, the situation reveals that regional players would not endure *relegation* to the status of a low development priority region in which only essential services for the population would be maintained. Those interviewed were calling for a rejection of structural and infrastructural development focussed on so-called beacons and a move towards the complete geographical spread of economic activity. Accepting economic and demographic decline and indeed playing an active part in these processes is inacceptable to the district authorities. Regional players are seeking to combat decline and generate growth with targeted efforts to bring companies to the region.

Sixthly, it would appear that there are not sufficient local competences to fuel an economic upturn in the regions without outside support. If the political objective is to bring every region to the same economic level, then a clear policy of attracting businesses is required to provide the necessary boost.

Seventhly, it would appear that regional structural policy needs in future to look more closely at particularly problematic situations, for example in very sparsely populated regions. This is also advocated by the *Landrat* in the light of infrastructures and services which are now extremely difficult to finance. Support could for example be help in dismantling sections of the infrastructure.

Eighthly, it is clear that strategic focus on clusters or competence fields competitive at a international level would not be useful in a region such as the Altmarkkreis. In other words, even if all available potential were used and developed, for example in the automotive industry or agriculture, the chances of creating a competitive cluster would still be slim. It therefore appears sensible not simply to look for internationally competitive clusters in such regions but rather to consider all competences and potential and to promote regional networks.

Ninthly, the example illustrates the results of backwash and spread effects:

Wolfsburg's automotive business creates both. The production factor work is drawn away, but not all those who find work in Wolfsburg move there as the high proportion of *out commuters* from the region shows. Part of the income earned in the *Wolfsburg area* is consequently spent in Altmarkkreis Salzwedel. Backwash effects however currently seem to be increasing as many are now moving to live near their place of work after years of commuting.

Companies from the automotive industry setting up business in the district could be seen as a spread effect, in particular as some have relocated from the Wolfsburg area. Nevertheless, and this is the general problem with spread effects, these new companies rarely offer jobs for the highly qualified. Most of the businesses are simply production plants and this increases interregional dependence. Newly arrived companies are moreover not "embedded" in the region and thus have little motivation to remain in the district if conditions become difficult.

Both backwash and spread effects are also evident in the finance industry: banks based in Lower Saxony have opened branches in Altmarkkreis Salzwedel or offer services there. These effects can on the one hand be seen as spread effects as the banks have created jobs in the region, invested capital and built up a banking infrastructure. On the other hand, the new banks and branches can also have backwash effects, namely if they offer no lending services but merely collect capital an then invest it in the booming centres. This effect worsens if the firms have no actual presence in the region as is the case with the VW-Bank.

7.5. Four Savings Banks and Four Regions: Conclusions

Savings banks do play a significant role in towns and cities but they are even more important for regional development in peripheral, in particular weaker regions, where they are also competitive in the long term. A project report from the European Commission suggests there is a danger that capital flow out of weaker peripheral regions of Europe owing to a lack of local financial institutions and that this exacerbate cumulative effects (European Commission 2004). The regionally-focussed savings bank system in Germany limits such developments, something which was reflected in the quantitative analyses in Chapter 6.

Regional savings banks are – as the four examples have shown – also important to the nationwide provision of credit facilities: geographical proximity plays an extremely important role in lending, at least in SME financing, despite the range of finance products available on the Internet. Banking markets therefore by no means operate in a spatial vacuum (see Chap. 1.3.3). Geographical proximity becomes even more important when companies experience cash flow problems, for savings banks' closeness to their customers allows them to apply specific know-how whilst their independence makes them more flexible than branches of major banks. Banks with a regional focus thus reduce national economic fluctuations (see Chap. 4.3) and fulfil an especially important function for weak regions, as companies there generally have a lower equity base and are thus at particularly high risk in *economic troughs*. The banks surveyed claimed it was more cost-effective for them as employees of a regional bank to obtain the necessary information to decide on loans than for private banks with only one local branch; this was due to stable customer-bank relationships and their knowledge of the market.

They also believed investments in customer-bank relationships had become more profitable through the withdrawal of private banks as the risk of the latter disrupting customer relationships was now slim. These findings confirm or illustrate the quantitative results in Chapter 6: savings banks in structurally weak and peripheral regions can also be viable. A far greater danger is the increasing competition from non-banks, near-banks and Internet banks in particular in retail banking (see also Chap. 3.4.2). Views differed among the various savings banks studied as to how to respond to growing competition on the banking market. Whether stiff price competition or a focus on quality is more appropriate depends on a range of factors including the geographical environment (urban or peripheral) and the competitive environment of the savings bank in question.

Regional stakeholders with a great interest in the location are essential not just to the provision of credit but also to the overall development of the location. The examples demonstrate that nationwide or region-wide presence is key to the development of urban districts and villages, for the bank branches are important focal points and thus strengthen polycentric spatial structures.

Savings banks are important players both in terms of balanced regional development and for the implementation of competence-based approaches and thus the exploitation of growth potential. The examples show that savings banks are able to adapt to regional circumstances and requirements with their specific financing instruments and in the focus of their regional economic involvement. Morawitz from the *Sparkasse Biberach* termed savings banks *learning institutions* which adjust to suit the regional situation and strategy but also provide new perspectives and know-how. However, the examples are no proof that all of the c. 470 savings banks support regional development in line with their public service obligation[62]. The four savings banks presented here can merely demonstrate what regional development potential regional banks have and what local regional players should be demanding of them.

62 Discussions with those working in the field of urban renewal (e.g. 38th Conference of the German-Austrian URBAN Network in Leipzig on 12th-13th October 2006) revealed that savings bank branches in structurally weak urban districts are not sufficiently involved in renewal, for example as part of local economic measures (see also Gärtner 2003: 113).

Regions' and regional players' ability to learn proves that savings banks are a flexible part of the governance structure. It can be assumed here that the ability of a region to cope with structural change also depends on regional players' ability to learn, although the possibility of a complete turnaround in regional development trends is fairly low.

That regional development is a constant and steady process is not the sole universal finding of regional economics which the examples above confirm. It is also clear firstly, that regional competences are to a certain extent path-dependent (in particular in Darmstadt); secondly, that regional development opportunities cannot be seen in general terms and must be considered solely in the context of a specific region and time (see in particular Biberach), and thirdly that regions are complex systems in which limited intervention can have significant consequences. New companies (see Biberach) can be a useful factor in boosting regional development, but their success should be assessed in the light of the global and regional economic situation.

An analysis of the regions also demonstrates that certain areas (e.g. Altmarkkreis Salzwedel) are indeed to be counted among the losers in competence-based regional policy, and that while spatial backwash and spread both take effect, any prediction of their relative scale and consequences is limited and thus their political use likewise. This poses the question of whether in future all regions should take on equal economic functions or whether a differentiated spatial model should be sought. Should the objective remain that of ensuring all regions fulfil specific economic functions then – in the hope that this will drive an independent regional upturn – an investment control policy in the form of business incentives is needed.

Clusters can contribute to regional success even if local players have not expressly pursued a cluster strategy (see Darmstadt and Biberach). Dortmund indicates that cluster management as a concept can be implemented despite a number of opposing voices, but the city's situation also proves that job creation effects are relatively small and that underlying development can only be altered slowly. Overall, the example of Dortmund shows that the relevant players' common vision is a prerequisite for regional development.

The role of universities and research institutions in regional development appears to differ or be perceived differently in different areas. Darmstadt has long-standing networks between research institutions and companies, the importance of which is underlined by all the relevant players. Research and networks in Dortmund were also highlighted although their importance should probably be relativised not least because the city's identity is not that of a centre of science. Biberach is production-oriented and many local companies have their own development departments. Local players interviewed believed the district's *Fachhochschule* as yet played no significant role but that this would change with the new *pharmaceutical biotechnology* programme. Altmarkkreis Salzwedel has no research institutions and the companies have a strong production focus. There is simply no research at this location and this is considered a major lack.

PART E - THE CHALLENGES OF A BALANCED STRUCTURAL POLICY

The Challenges of a Balanced Structural Policy

Part B of this study established that newer structural political approaches and spatial economic concepts are increasingly designed to promote competences available locally and focussing on the concentration or specialisation of economic activity within a region. It is to be inferred that certain regions will benefit from this change in focus whilst others will be disadvantaged.

Parts C and D set out the importance of savings banks, in theory and in practice, in a balanced structural policy focussed on growth and equalisation. Savings banks are successful even in weak regions and can therefore help prevent weaker areas from suffering. Furthermore, the profile of the four regions studied (see in particular the description of in Chap. 7.4) clearly demonstrates that weak regions with only limited national competitive potential could profit little from a growth-oriented structural policy.

This poses the question of what form a balanced structural policy should take and how savings banks can support such a policy. Chapter 8 examines this question in detail. The study ends with a summary and conclusion (Chap. 9).

8. SAVINGS BANKS AS PLAYERS IN A BALANCED STRUCTURAL POLICY

More recent structural political approaches and spatial economic concepts are increasingly designed to promote competences available locally and focussing on the spatial concentration or specialisation of economic activity. Such approaches could in theory contribute to national economic growth but the spatial distribution of growth potential is uneven: it is often available in successful and less frequently in weaker regions. This puts the latter at a disadvantage, a disadvantage which runs counter to the traditional objectives of regional structural policy, namely equalisation.

This is also one of the reasons a regional structural policy which concentrates funding on growth regions is extremely hard to implement and indeed to justify in political terms – hence the often nationwide or region-wide application of growth-based instruments, or their intense use in structurally weak regions in efforts to support independent economic development there. Yet such instruments have only a limited effect in regions which lack sufficient potential, and in overall economic terms it makes little sense to roll out the cluster approach across the board. Resources are in this case spread so widely that the concentration or critical mass necessary for growth poles or clusters cannot be achieved anywhere.

However, the conclusion that regional structural policy should therefore concentrate exclusively on growth is not an advisable alternative. First of all, this could have considerable follow-up costs; secondly, it is impossible to say with any certainty which areas will drive growth in future; thirdly, there is nothing to prove that such approaches necessarily produce the optimal overall economic results and, fourthly, there is a danger no individual talents and skills will emerge if support, even in the essential services and education sector, is no longer given to these areas. It is therefore vital that access to basic infrastructures at least be guaranteed in all regions, above all in the education sector.

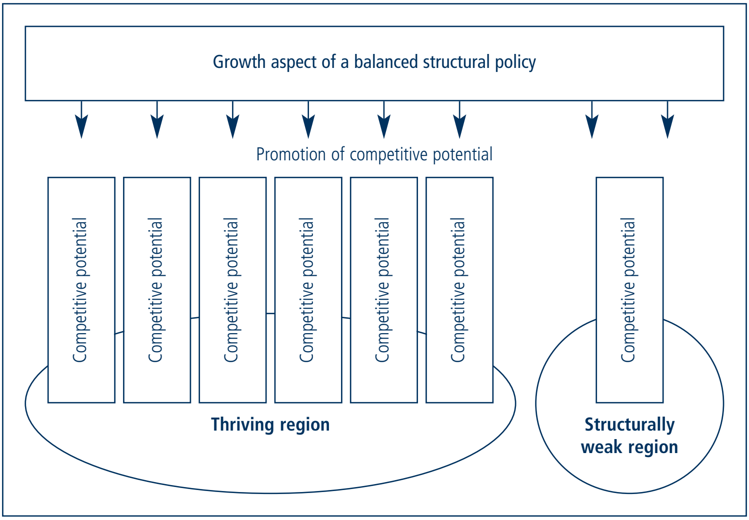
Continuing weak economic growth, persistently high unemployment rates, population decline, tight public finances, little remaining business potential or frequent free-rider effects in incentive policy, and depopulation or landscape fragmentation as a result of nationwide and region-wide transport infrastructures all cast doubt on whether redistribution or the broad spread of scarce growth potential across the regions could still make national economic sense. The regional economic justification is that specific supply structures, infrastructures and employment markets with socioeconomic benefits can shape regions' long term success. A structural policy focussed exclusively on equalisation which, as was often the case in the past, attempts to develop structurally weak regions by controlling investment thus appears as far removed from optimal regional structural policy as one focussed solely on growth.

Balanced structural policy should therefore both promote national growth potential where available and, in weaker areas, support regional value chains, build on specific endogenous potential arising despite or because of demographic and economic decline and develop or maintain essential social, consumer, education and cultural infrastructures using targeted and flexible instruments. Such a policy should be based on three key principles: firstly, and this applies equally to the growth-oriented and equalisation-oriented aspects, potential available in the region must be developed. Development should centre on the available "territorial capital" (Leber/Kunzmann 2006: 67) or "implementation potential" (Hübler 2005: 60) and players with a knowledge of the regional infrastructure are vital if it is to succeed. Secondly, that regional value chains form the basis of regional structural policy. In terms of growth-oriented structural policy, this means that clusters of national importance should be supported; in equalisation policy it could also mean the regional processing and sale of food products should be promoted. The third aspect is that equalisation-oriented policy should focus more strongly on a supply and service provision strategy, i.e. independent economic development is not necessary in and by all regions.

Care must be taken in general to ensure that a balanced structural policy aimed at growth and equalisation does not simply become a watered-down growth-oriented strategy, but that there is instead a clear and useful separation between growth-oriented and equalisation-oriented structural policy. Policy cannot distribute growth potential, it can merely support its development.

Such a structural policy should, as shown in the diagram below, promote national strengths regardless of whether these are to be found in structurally weak or successful regions.

Figure 23: Balanced structural policy: the growth aspect



The fact that national competitive potential is unevenly distributed and found less frequently in weak regions should mean these very regions receive particular support. The fundamental condition for determining which regions are to benefit from equalisation-based structural policy must be regional need. Regional need in this sense should not be measured exclusively on the state of the regional economy but also on particular problems such as very low population density, significant decline, extremely peripheral location etc.

The following sub-chapters finally depart from the *could, would and should*, roughly outlining what must be considered in balanced structural policy (Chap. 8.1) and how local savings banks can support such a policy (Chap. 8.2).

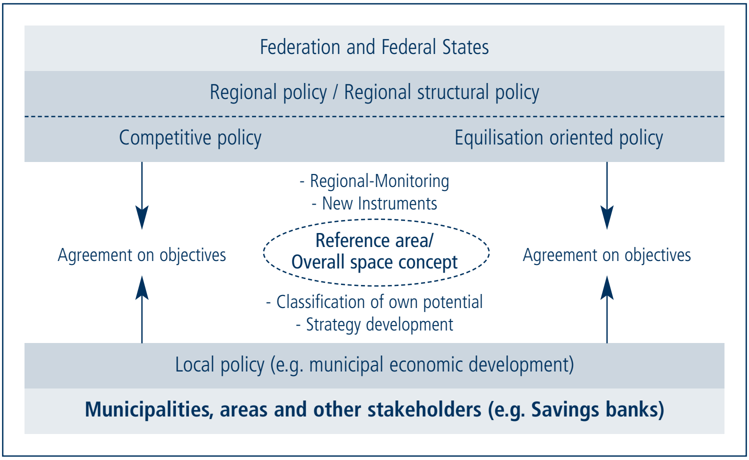
8.1. Balanced Structural Policy

Implementation of a balanced structural policy requires a common focus at all levels of the spatial hierarchy and on the part of players and stakeholders involved on the ground (Chap, 8.1.1); it demands a new spatial model (Chap. 8.1.2) which allows for areas' varying economic functions; concerted action in a broader spatial context (Chap. 8.1.3) as economic structural competences do not recognise political boundaries, and a flexible public service model (Chap. 8.1.4).

8.1.1. A Common Focus Across the Spatial Hierarchy

Balanced structural policy places demands both on highest level of the spatial hierarchy – regional policy or regional structural policy – and on local players implementing location policy. Figure 7 (Spatial economic policy hierarchy) in Chapter 2.3 illustrates this point. Figure 24 demonstrates that a combination of top-down and bottom-up approaches is as essential to growth as to equalisation policy: in other words, it is important that local and regional/national players have a common focus.

Figure 24: Balanced structural policy: levels involved in implementation



Players at a higher level must have an overall picture of relevant growth potential and development problems in the various regions.

It is also vital to both successful and structurally weak regions that strengths and weaknesses be identified; that local players gain an awareness of regional functions in geographical role allocation and of regional identity and draw up development concepts designed to deal with the actual situation. The participation of national – and thus more neutral – players in drafting such development concepts produces strategies based on the real situation. A type of *clearing body* could well be used here. It would act as an interface between location policy and regional structural policy, provide specific competences and experience (assessment of *good practice*) and help draft suitable action plans. This applies both to the development of competitive growth fields and to support for structurally weak areas. For example, individual target agreements could be reached with players in declining areas to guarantee financial support in organising and adapting the infrastructure.

The development of growth poles also requires a common focus on the part of national and local or regional players, but this does not mean agreement between all levels should be sought on overall regional economic development. A common focus on the growth fields which play such a key role is more important. In concrete terms, this means that basic strategic focus is determined at the highest level (top-down) but then detailed or supplemented by the lower levels of the spatial hierarchy (bottom-up).

8.1.2. New Spatial Models

A balanced structural policy which gives equal weight to growth and equalisation can only be implemented if its consequences are transparently communicated and regions accept the different functions allocated to them. This can mean individual areas must permanently abandon any ambitions perform independent economic function. Accepting regional inequalities is in direct contradiction to the traditional equalisation goals of regional structural policy in Germany. Just how thoroughly and consistently such a structural policy should be implemented cannot be outlined in detail here and is also dependent on the type of region, for example old industrial and urban or structurally weak, agricultural peripheral regions. For the former, the large population alone may mean it does not make sense to weaken the areas so greatly that partially or completely dismantling the infrastructure is the only option remaining.

The consequences of such a structural political model are clearest in peripheral agricultural regions. Independent development must, it is true, be supported in these regions too – but not by attracting private or public investments if these have little prospect of creating a self-sustaining regional upturn. An equally critical approach should be taken to policy which focuses on the transport infrastructure in peripheral regions, splitting up the few remaining relatively traffic-free areas even further in the hope of boosting development and destroying ecological potential in the process.

The focus should instead be on structural political support for economic activity in structurally weak peripheral agricultural regions, activity which boosts regional output. This is turn will promote internal income cycles and thus contribute to economic stabilisation. It is true this does not mean that many of the weak areas would be able to survive from regional value chains alone, yet a new understanding of regional development is needed on this very issue: there is nothing to suggest ecologically-oriented self-sustaining regional development is incompatible with permanent State support, in particular if such a policy is overall less of an economic burden than one of investment control. Regions which perform an ecological (mitigation) function provide national economic or social benefits for which they must receive financial compensation in a market economy (see the discussion of Odenwald Chap. 7.1.4).

Discussions on a new spatial model must also determine how "equal living conditions" are to be understood, for statistical values say relatively little about quality of life as it is subjectively perceived. Nonetheless, statistics proving that regional economic living conditions are worse in weak peripheral areas cannot simply be *defined away* by altering indicators for measuring *isolated regions* and switching the focus to quality of life, for example the unspoiled natural environment.[63] A structural political model must therefore also be discussed in the light of new ways of financing and organising transfer payments aimed at giving those affected a share of economic benefits.[64]

63 Various studies have shown that perceived quality of life correlates more closely to the unemployment rate than to disposable income (e.g. BBR 2005b: 6ff.). The opportunity to lead an independent life thus appears more important that the level of actual income. Paid employment is one of the main prerequisites for independence and is also important for reasons of social recognition (e.g. Weck 2005: 9).

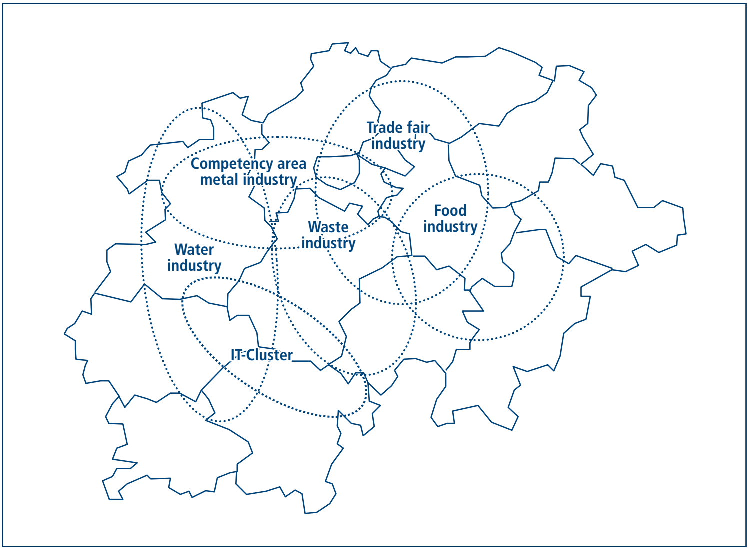
64 The debate should also consider forms of guaranteed Grundsicherung [social security payment to keep pensioners and low earners above the poverty line] or Bürgergeld [negative income tax] discussed as part of welfare system reform and in the light of findings that paid employment in society is decreasing. The transfer of income or purchasing power these approaches involve could also make them a suitable instruments for avoiding cumulative effects in weak regions.

8.1.3. New Spaces of Perception and Action

Regions with their regional-specific potential are important implementers of balanced structural policy as defined in this study. Local economic structural competences and regional networks combined with milieu and cultural factors, knowledge cultures and urban structures form the fundamental basis of independent regional strategy, but its scope usually extends beyond regional political borders. It follows its own logic and varies in rigidity or flexibility, but are not without commonalities and areas of integration. The discovery that spaces of perception and action and social or relational areas differ from administrative regions (e.g. Bormann 2001, Blotevogel 1995, Läpple 1991) is not a recent one, yet little attention is paid to regional or national spatial connections between municipalities and districts.

Discussions have been underway for some time now on cooperation between municipalities (e.g. Danielzyk/Rietzel 2003, Heinz 2000, Kistenmacher et al. 1994) in order to overcome *parochialism* and avoid the unnecessary competition often played out between smaller municipalities in particular. However, examining overlaps in spatial scope does not mean balanced structural policy is aimed at specific collaborations with neighbouring municipalities or redrawing the local authority boundaries. What is important here is to pinpoint the possible areas affected by various measures or issues, of which a sample is presented in the diagram below. Spatial units affected are defined functionally as well as territorially but should be located territorially in terms of possible courses of action. This is important not least because competence-based approaches focus on economic networks and value chains which are not limited to administrative regions and, depending on the issue, affect different and overlapping political units. A clear reflection of this is the location of regional production clusters (*Akademie für Raumforschung und Landesplanung* [Academy for Spatial Research and Planning] 2006: 4). Policy focussing on spatial scope must look at areas' position as living or cultural units and not be limited to areas with potential for economic development and clusters. What form these spatial interconnections take within location development depends on a range of factors including the type of region and the place’s position within it (see also details on Darmstadt in Chap. 7.1.4).

Figure 25: Spatial scope



8.1.4. Flexible Public Service Provision

Structural policy focussed on growth and equalisation is, it is true, based on a model in which not all areas are economic development priorities, but essential services in the sense of public service provision and as far as possible also in terms of economic infrastructure should nonetheless be maintained throughout the country and individual regions.

Public authorities' ever tighter financial margins nevertheless mean that great efforts will be required to maintain structurally weak regions, especially declining peripheral areas, at their current level. Minimum standards to be met in all regions are often debated in this context (e.g. Hahne 2005: 263ff.). These should not be too rigid and must allow for flexible or mobile and innovative service provision. The guiding principle should be not to cling to the traditional but rather to achieve the best possible quality of life for people living in weaker urban districts and villages.

Citizen involvement and that of local companies must also be encouraged and new, cooperative forms of public service provision developed. Old industrial towns and disadvantaged urban districts have particular problems, for example marginal groups which have failed to integrate and sections of the population with no academic background or connection.

Public services cannot be defined solely from a local authority administrative perspective. For peripheral, sparsely populated regions, this could for example mean local groups organising commercial infrastructures which the inhabitants want but which are not viable and therefore no longer provided by the authorities. A good example here is the *Nachbarschaftsläden* (neighbourhood shops) run by local village communities which have sprung up in recent years (Hoffmann 18 November 2005). Funding programmes to promote such developments trigger public involvement and help communities help themselves. Local consumers can themselves decide how valuable such projects are to regional development through their purchasing behaviour and willingness to make a personal commitment.

Public service provision in this context activates, coordinates, controls and guarantees. It is important to prevent spatially concentrated cumulative effects, actively develop the infrastructure and last but not least ensure access to national social development.

8.2. Savings Banks as Players in a Balanced Structural Policy

As this study has demonstrated, savings banks are important players in regional location policy. They could exercise this function with greater dynamism and focus in the context of a balanced structural policy. Just how is outlined below.

As already demonstrated, a *common focus* among the *different levels of the spatial hierarchy* is needed in order to create a consistent regional development strategy. Savings banks can help raise local awareness of the current regional situation, identify strengths and weaknesses and develop action plans. The focus must be on the area's actual strengths – it is important to avoid creating imaginary competences in an excess of wishful thinking. Savings banks can fulfil a kind of selection function, especially when they are to be involved in financing development concepts. This could include scrutinising the development of new commercial and residential areas in declining regions.

Savings banks should also develop new instruments at the interface between banking and structural policy in order to promote regional potential. As regards the cluster policy and competence field debate, they could for example promote regional networks and innovative financing instruments for cluster management – perhaps with gradually decreasing funding and increasing stakes in the companies such funding benefits. Risk and venture capital finance are on the rise and savings banks should therefore become more involved in new forms of financing, for geographical proximity offers potential advantages even with these finance models. Regional banks thus have the chance to compensate for any profits lost as lending relationships are standardised (see Chap. 1.3.4). A particular gap in supply exists in the seed financing sector, i.e. finance for the first stage of company foundation, as players on the ground highlighted (see Chap. 7.2.3).

The analyses clearly show (see Chap. 6.2.2) that the size of savings banks corresponds to the regional situation. This means that savings banks in sparsely populated regions are significantly smaller than in urban areas in terms of the volume of business. One question to be addressed is how savings banks should respond to possible local area boundary reforms and district mergers, primarily in rural areas. Savings banks operating in too large areas could lose their regional ties or start to concentrate on geographical centres, and this in turn could mean a lack of services in certain areas. Regional-specific merger concepts must for this reason be based equally on economic areas and banking necessity, this in light of the fact that economic structural competences and regional positioning options do not stop at political boundaries. As already discussed, both structural players and savings bank policymakers must therefore learn to operate in new *spaces of perception and action*. Just as the purpose of location development is cooperation on specific issues and not the creation of new, inflexible administrative units, savings banks should not always opt for immediate mergers. Specific interest groups with neighbouring savings banks are a practical alternative and should be developed further. Savings banks can, moreover, play help determine relevant spatial connections and overcome political parochialism.

The above analyses have shown that savings banks in weak peripheral areas are at least as successful as those in the centres – an important finding for equalisation-based structural policy – but profits are slightly lower in extremely sparsely populated eastern German regions. Savings banks in regions in economic and demographic decline will, moreover, most likely have problems adapting fast enough to the new situation and in reducing their capacity. Savings banks must develop concepts to solve the problem of how institutions can meet their public service obligation in rapidly declining areas where economic activity and population density have fallen below a certain threshold; how they can also support regional development and at the same time consistently generate sufficient profits. For the balanced structural policy advocated here, this question is a particularly pertinent one in the stabilisation of weak peripheral areas. Savings banks in weak urban districts and declining regions should also support projects aimed at endogenous service provision, promote *flexible public service provision* and encourage local public involvement. This strategy, coupled with efforts to promote regional identity, could ultimately result in the development of alternative trade and exchange schemes – many such *local exchange and trading systems* (LETS) have already been set up in Germany and abroad. The point is for communities to promote regional ties and improve local quality of life rather than cut themselves off from the national or global economy.

Savings banks should also develop micro-finance instruments (e.g. micro-lending) which are designed to deal with the specific situation in structurally weak urban districts. Such instruments are used above all in countries where banking service provision is poor (see text box in Chap. 3.4.1): so-called *community development financial institutions* or *credit unions* have been set up in Britain, for example, in some cases with State funding. Community development financial institutions include various types of non-profit financial intermediaries which offer finance products primarily for micro-companies and poorer sections of the population. Some of the instruments are extremely innovative – involving for instance a different system of securities based partly on the individual or collective responsibility of start-up founders. Just as the decentralised savings bank system could offer other countries inspiration and ideas, experiences in other countries too could also offer inspiration to savings banks in Germany.

Implementation of balanced structural policy is not the only challenge for regional savings banks, however *Sparkassen* must also adapt to a new business environment, first and foremost in the light of increasing competitive and price pressure – in the retail banking sector at least – with the emergence of direct and Internet banks. Views on how savings banks should respond to this development vary between regions and savings banks to savings bank, but one point will be key in future no matter what the solution: banks must make more use of the association and reduce the range of processing work carried out in the single savings bank. Quantity effects and therefore cost reductions could and should also be achieved through closer cooperation between neighbouring savings banks.

Changes in the business environment are also occurring through the standardisation and harmonisation of the lending markets with the result that competitive advantages in information are to a certain extent being lost. The analyses have shown that social capital and concentration on the region are essential to the economic success of regional banks (see Chap. 1.3.4). Information capital, in some cases a product of experience available only in employees' brains is a not insignificant asset for regional banks. The introduction of IT-based scoring systems and Basel II risks undermining the importance of traditional customer-bank relationships grounded on customer proximity and the competitive advantages these offer. Savings banks must therefore find a way to exploit the efficiency benefits of automated and standardised instruments on the one hand and on the other to continue using the *advantages of contact* in future and thus support regional development. One option might be to channel knowledge of the regional economic structure into the scoring model or apply it to rating processes (Basel II). Companies' position in the regional value chain can reveal more about risks and potential profits than the sector to which they belong.

Savings banks cannot stop at active involvement in regional development. They must also transparently communicate and make a permanent commitment to the work they do for the region. One possibility would be the development of a standard by which all savings banks quantify their contribution to the region. These findings could both be used in local communication and collated and communicated at a national German or EU level.

The transparency and comparability this system would create would necessarily oblige savings banks to make a permanent commitment to the region. *Kreissparkasse Biberach* (see Chap. 7.3.3) is a good example of how banks' fulfilment of their public service obligation can be transparently communicated.

Local savings banks, it is true, have a major part to play in implementing balanced structural policy, but they are also dependent on the support of the entire *Sparkassenfinanzgruppe* in this work. Savings banks need specific knowledge of spatial development, and a sufficient level of expertise in this field is not available across the board. The DSGV, the regional associations and the *Landesbanken* must all contribute their know-how so that they can develop the region or carry out the necessary analyses in partnership with the local savings banks. Not only that, but regional and location development competence should be part of internal savings bank courses and professional development programmes. Just as bank-specific competences should be provided for individual savings banks, spatial development competences should also be available within the association and the savings banks made aware of this.

This study has demonstrated that savings banks have the potential to support balanced structural policy. The savings bank organisation would be well advised to make use of this potential and truly operate in all areas as *regional banks with regional responsibility*. The *Sparkassenfinanzgruppe* should be able to provide the motivation and competence necessary.

9. CONCLUSION

This study was centred on a balanced structural policy to support national growth potential and regional value chains in weaker regions, with the key aim of preventing spatially concentrated cumulative processes.

Such a structural political strategy requires a new spatial model; a model which allows for a more distinct definition of spatial functions and for significant decline in certain areas. Equality in this model is seen more in qualitative than economic terms, i.e. subjective perceptions of quality of life. A new spatial model allowing decline is far more acceptable to more or less functional, sparsely populated peripheral rural districts than densely populated old industrial towns.

A structural political concept aimed at growth and equalisation, building on locally available competences in strong and weaker areas alike, requires regional players and stakeholders. Regional players who are willing and able to develop the location together whilst also contributing to complete equalisation. Germany's decentralised savings bank system has a key role to play here.

Firstly, savings banks' close links to the local economy, networks of knowledge and ability to lend fits them for an active role in shaping local potential and competence fields.

Secondly, and this is particularly essential to weaker areas, they guarantee banking and lending services for all areas. Savings banks are bound to the region by the principle of regionalism and may in principle only invest the money deposited in their own region.

The qualitative analysis of four savings banks showed the banks are important players from more than a simply abstract perspective. They guarantee the provision of banking and lending services in urban agglomerations – including urban districts with considerable development problems – and extremely peripheral regions alike.

Savings banks' importance as decentralised regional banks is also significant because geographical proximity is vital in SME lending despite the range of online financial products, and banking markets by no means operate in a spatial vacuum. Geographical proximity is even more relevant when companies experience cash flow problems or run into financial difficulties, for savings banks' closeness to their customers allows them to apply specific know-how while their independence makes them far more flexible than branches of major banking groups. Savings banks are thus important players both in terms of balanced regional development and for the implementation of competence-based approaches and thus the exploitation of unused growth potential. This is of particular interest for a decentralised country like Germany where many different economic centres have developed over time.

Over the last ten years, savings banks posted higher profits than their private sector competitors either *despite or because of* their public service obligation. However, it was debatable whether they are sufficiently profitable in peripheral and structurally weak regions to contribute to regional development there. The principle of regionalism which restricts capital mobility and requires that capital saved be reinvested in the region thus – at least in theory – also poses a problem: savings banks are tied to their region and may not invest in others, and banks in weak regions may therefore generate lower profits.

Profitability analyses of all savings banks in Germany and the areas in which they operate have however found that savings banks in weak and peripheral regions are at least as successful as those in prosperous urban areas. Savings banks would consequently be well advised to retain the principle of regionalism not only for regional economic reasons but also because it makes business sense. It should be remembered that close ties to the region are essential to savings banks' success, and operating in all regions also appears sensible as resources – from a business as well as a regional perspective – would otherwise remain unused.

Any proponent of classic banking theory which disregards factors such as geographical proximity, trust and knowledge of the local markets would find it hard to explain how banks, forced by regional circumstances to limit themselves to a weaker customer group, still manage to generate similar or even higher profits than those in prosperous areas. Economic instinct suggests that banks in prosperous urban regions have a better profit outlook than those in weak peripheral areas. In the latter, they serve a more scattered population, the number of bank customers per branch is smaller, incomes are lower and there are fewer factors driving development. However, if elements of new banking theory are considered in the light of spatial economics, quite different conclusions can be drawn, and also empirically confirmed as the results of the analyses have shown. **First of all**, private commercial banks have withdrawn above all from structurally weak and peripheral regions and left this area to the cooperative and savings banks. **Secondly**, the lower level of local competition can favour stable customer-bank relationships; this reduces information asymmetries, it becomes worthwhile to invest in obtaining information and take on greater risk, for instance in the start-up finance sector. **Thirdly**, savings banks' business model enables them to operate flexibly at a local level, use their knowledge of the market and at the same time ensure cost-effective processing through the association, in particular for back office work. It can be assumed that the link between regional structural weakness and banks' potential profits lies primarily in a business model which allows both close local regional ties and the use of scale effects through the association.

The savings banks would be well advised to hold on to the competitive advantages of geographical proximity and close relationships with their customers, advantages which could be undermined as lending procedures are standardised (e.g. Basel II). They must also develop strategies for continuing to fulfil their obligations in regions facing significant population decline whilst also generating the returns they need to remain viable. The same applies for structurally weak urban districts. Here, the banks should participate in structural political development, creating specific instruments which also promote less advanced areas of the economy. Experiences in other countries could provide useful inspiration for such a strategy. Last but not least, savings banks should communicate their contribution to regional development far more clearly and transparently.

PART F - APPENDIX

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1.3. Interviews

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- **Arnold, G.**	Spokeswoman of the Board of Directors, *Sparkasse Altmark West*
- **Blüml, W.**	*Leitender Regierungsdirektor und stellvertretender Landrat* [Chief government official and deputy leader of the district authority
- **Böther, U.**	*Sparkassendirektor* [Savings Bank Manager], Sparkasse Altmark West
- **Ellerkamp, T.**	*Wirtschafts- und Beschäftigungsförderung Dortmund* [Dortmund Business and Employment Agency], Deputy Manager
- **Glaser, Dr. J.**	Cluster Development Project Manager at Wachstumsinitiative Süderelbe AG, Hamburg
- **Hein, Dr. W., Prof.**	*Deutsches Übersee-Institut* [now the German Institute of Global and Area Studies], Hamburg
- **Helmstädter, Dr. E., Prof.**	Research Professor at the *Institut Arbeit und Technik*, Gelsenkirchen

- Henneke, Dr. H. G., Prof.	*Hauptgeschäftsführer des Deutschen Landkreistag* [Director of the Association of German Counties]
- Kolb, M.	*Abteilungsdirektor Unternehmerkunde* [Head of the Corporate Customers Division] at *Sparkasse Darmstadt*
- Kolmer, M.	Deputy Director of the *Amt für Wirtschaftsförderung* [Business Development Agency] of the City of Darmstadt
- Lammers, Dr. K.	Head of the Department of European Integration, Hamburg Institute of International Economics
- Läpple, Dr. D., Prof.	*Lehrstuhl Stadt- und Regionalökonomie* [Chair of Urban and Regional Economics], Hamburg University of Technology
- Lehr, P.	*Abteilungsdirektor Betriebswirtschaft* [Business Division Manager] at *Sparkasse Darmstadt*
- Morawitz, Dr. C.	Vorstand er der *Kreissparkasse Biberach*
- Neben, H.	*Kreditabteilungsdirektor* [Lending Division Manager], *Sparkasse Altmark West*
- Ostermann, H.-J.	*Landrat*, Altmarkkreis Salzwedel
- Röllinghoff, Dr. S.	*Wirtschafts- und Beschäftigungsförderung Dortmund, Fachreferent der Geschäftsführung* [Management Representative and Spokesman]
- Schmitt, W.	Spokesman for the Board of Directors, *Kreissparkasse Biberach*
- Sellner, G.	Chairman of the Board of Directors, *Sparkasse Darmstadt*
- Spehl, Dr. H., Prof.	*Lehrstuhl für Volkswirtschaftslehre* [Professor of Economics], University of Trier
- Steemann, D.-K.	*Teamleiter Branchen- und Technologieentwicklung* [Sector and Technological Development Team Leader], *Wirtschafts- und Beschäftigungsförderung Dortmund*
- Steinkamp, G.	Managing Director, S-Venture capital Dortmund GmbH
- Stickel, Dr. G.	*Leiter Vorstandssekretariat* [Head of the Executive Secretariat], *Kreissparkasse Biberach*

-	**Straub-Neumann, U.**	Press and Public Relations Officer, *Kreissparkasse Biberach*
-	**Weigele, Dr. O. M.**	Chairman of the Board of Directors, *Kreissparkasse Biberach*
-	**Weiser, K.-H.**	Head of the *Gründungs- und Innovationscenter* [Innovation Centre], *Sparkasse Dortmund*
-	**Wurzel, C.**	*Vorstandssekretariat* [Executive Secretariat], *Sparkasse Dortmund*
-	**Zimmermann, Dr. Dr. H., Prof.**	*Präsidium der Akademie für Raumforschung und Landesplanung* [Chairman of the Academy for Spatial Research and Planning], Hanover

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1.5. Structural Data on Four Regions and Savings Banks (Chap. 7)

Selected structural data from the regions studied (status as at 2003)

Regional data	Germany	Darmstadt	Hesse	Dortmund	NRW	Biberach	Baden-Württem.	Altmarkkr. Salzw.	Sachsen-Anhalt
Percentage employed in service sector (%)	62.7	67.2	67.0	70.6	63.2	50.2	58.6	56.8	61.8
Percentage employed in knowledge-intensive corporate services	7.6	16.8	10.5	10.8	8.0	3.9	7.4	2.7	5.2
Percentage employed in the primary sector	2.4	0.3	1.6	0.5	1.5	4.2	2.1	7.7	3.4
Percentage employed in the secondary sector	27.2	23.1	24.5	16.6	26.6	43.1	34.3	30.9	26.1
Percentage employed in the tertiary sector	70.4	76.6	73.9	82.9	71.9	52.8	63.6	61.4	70.5
Net migration per 1000 inhabitants	1.7	6.2	0.8	1.2	1.9	4.2	2.9	-6.9	-5.2
In-commuters in % of working population	37.0	68.7	45.5	41.0	37.0	20.0	34.1	23.3	32.0
Out-commuters in % of working population	36.7	42.5	42.0	33.3	35.7	24.6	31.4	38.4	38.4
Gross domestic product in €k per inhabitant	25.8	52.4	31.2	27.6	26.0	27.0	29.2	14.7	17.7
Ratio of built-up to open spaces	0.13	0.44	0.16	1.13	0.24	0.11	0.14	0.06	0.10
Access to motorway by car minutes	17	5	14	10	11	35	18	54	28
Access to regional centres by car in minutes	35	0	26	0	29	35	31	59	44

Source: BBR 2004 and 2005a

Selected structural data from the savings banks studied

Indicators	Darmstadt	Dortmund	Biberach	Altmark West	German average
Total assets in €k (99-2003 average)	3 229	6 257	3 789	794	2.058
EKR (99-2003 average)	17.2	10.9	23.4	15.9	12.58
CIR (99-2003 average)	64.12	no data available	56.6	60.85	66.60
Employees/Trainees 2004	887/53	1 994/138	734/71	235/20	-
Change in employee/ trainee numbers 2000-2004	-27/-11	-43/-6	68/9	-15/-6	-
Change in no. of branches (including agencies and subsidiary branches) / 2000-2004	42/-5	80/0	76/-26	18/-16	-

Source: Financial statements and information from the savings banks, DBB 2005a, author's calculations

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WSBI – ESBG – The Global Voice of Savings and Retail Banking

WSBI (World Savings Banks Institute) is one of the largest international banking associations and the only global representative of savings and retail banking. Founded in 1924, it represents savings and retail banks and associations thereof in 92 countries of the world (Asia-Pacific, the Americas, Africa and Europe – via ESBG, the European Savings Banks Group). It works closely with international financial institutions and donor agencies and promotes access to financial services worldwide – be it in developing or developed regions. At the start of 2008, assets of member banks amounted to more than €9,800 billion, with operations through more than 191,000 branches and outlets.

ESBG (European Savings Banks Group) is an international banking association that represents one of the largest European retail banking networks, comprising about one third of the retail banking market in Europe, with total assets of € 5,980 billion (1 January 2006). It represents the interests of its members vis-à-vis the EU Institutions and generates, facilitates and manages high quality cross-border banking projects.

WSBI and ESBG members are typically savings and *retail* banks or associations thereof. They are often organised in decentralised networks and offer their services throughout their *region*. WSBI and ESBG member banks have reinvested responsibly in their region for many decades and are one distinct benchmark for corporate social *responsibility* activities throughout Europe and the world.

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