Cost and profit efficiency of financial conglomerates and universal banks in Europe

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Abstract
In contrast to the U.S. where universal banking has been legally prohibited, the Second Banking Directive allows European banks both to form financial conglomerates and hold equity stakes in non-financial companies. This paper analyzes the cost and profit efficiency of European financial conglomerates and universal banks. We find that conglomerates are more revenue efficient than their specialized competitors and that the degree of both cost and profit efficiency is higher in universal banks than in non-universal banks. These results indicate that the current trend towards further de-specialization may lead to a more efficient banking system. An investigation of the equity betas under varying business cycle conditions supports the hypothesis of superior monitoring capabilities on the part of universal banks. Finally, profit regressions suggest that operational efficiency has become the major determinant of bank profitability and that oligopolistic rents have become less prevalent in European banking.

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