The Deutsche Bank/Dresdner Bank merger: a struggle for worldwide market domination

Patrick Richter
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The merger announced on March 7 of Deutsche Bank AG and Dresdner Bank AG, Germany's largest and third-largest banks, respectively, to form the biggest financial institution in the world is the German response to increasingly tough competition for domination of the world financial markets. It signals the beginning of profound changes in Germany's economy.

Deutsche Bank CEO Rolf-Ernst Breuer explained the decision in favor of the merger by saying, "We didn't want to be driven [by the competition]", thus expressing a widely held desire in business circles to at long last take the initiative against increasingly overpowering foreign competition and rid themselves of the dead weight of the "Germany-Incorporated" system of market regulation and social concessions.

The merger will create the most powerful banking group in the world with a balance-sheet total of nearly 2.5 trillion marks, and a stock market value of around 150 billion marks. This puts it far ahead of the second largest banking group, US-based Citigroup, with a balance-sheet total amounting to 1.2 trillion marks, and also in front of the planned Japanese bank mergers of Dai-Ichi/Fuji/ Industrial Bank (2.4 trillion marks balance-sheet total) and Sumitomo/Sakura Bank (1.7 trillion marks balance-sheet total).

The new banking group intends to spin off its retail banking business, which is running at low profit at Deutsche Bank and especially at Dresdner Bank, and the costly, extensive network of bank branches associated with it. A total of 800 of the 2,500 existing branches are to be closed in the next few years, a move that will cost 5,900 workers in this sector their jobs by 2002.

All told, the planned restructuring will result in 16,000 employees out of a total workforce of 120,000 (75,000 at Deutsche Bank and 45,000 at Dresdner Bank) losing their jobs in 2001 and 2002. The merged bank hopes to reduce costs by nearly 5.9 billion marks a year.

The future core business lines of the new mega-bank, which will retain the name Deutsche Bank AG, but adopt the Dresdner Bank's green corporate colour in its logo, will include investment banking, a field of business in which all-out international competition is seething; asset management, where the new banking group hopes to outstrip the traditionally dominant Swiss banks; security and loan banking; and financing for corporate clients ranging from major industrial corporations to mid-scale companies, where the new group will be the most powerful financing institution in Europe.

In the field of investment banking, which involves the trading and placement of securities and stocks in international stock exchanges, Deutsche Bank and Dresdner Bank have been jockeying for a better market position against each other, particularly in foreign markets, over the past few years. But continuously increasing competition from the US, Britain and the Netherlands, where a concentration has been taking place in the banking sector for years, was putting more and more pressure on Dresdner Bank particularly, but also on Deutsche Bank.

Although Deutsche Bank's take-over of the London-based investment group Morgan Grenfall in 1993 and of the US Bankers Trust group in 1997 allowed it to become one the world's major investment banking groups (ranking as the eighth largest bank in the US, for instance), this still didn't solve its main problem: cost.

The average ratio of costs to returns among German banks is 70 percent; as opposed to this, British banks keep that ratio as low as 40 to 50 percent. In terms of return on equity, the most important parameter for profitability in the stock market, Deutsche Bank is at 14 percent, which is high for Germany, and Dresdner at 8.7 percent. The average return on equity rate of British banks is 20 to 30 percent.

This resulted in a situation where Deutsche Bank, despite its 1.6 trillion marks balance-sheet total, had itself come to be regarded as a buyout candidate in the international finance markets, and has now taken over Dresdner Bank (despite all the talk of a "marriage of equals").

By American or British standards, many German banks have long since slid down into the "buyout candidate" category. They have the typical characteristics of that category: low return on equity and high cost segments, partially unprofitable industrial holdings and expensive encumbrances such as retail banking. Commerzbank AG and HypoVereinsbank have already been targeted as potential candidates for merger or acquisition.

Despite enormous efforts in advertising and branch establishment, the German private-sector banks have not succeeded in recent decades in substantially improving their share of private customer business in relation to the municipal savings banks and mutual savings banks, which in 1998 still controlled nearly 80 percent of that segment.

This is why the spin-off of branch-based retail banking to Bank 24, which is scheduled to be floated on the stock market in three years, is one of the main elements of the merger deal. The Allianz AG insurance group (which played a central role in the merger due to its nearly 5 percent stake in Deutsche Bank and 21.7 percent stake in Dresdner Bank) plans to become the 49 percent minority shareholder of the new Bank 24 in order to sell its insurance policies, investment trusts and portfolios through the bank's structures.

This merger is going to make decisive inroads into Germany's banking system. Deutsche Bank CEO Rolf-Ernst Breuer sees it as "the end" of the classic German general-purpose bank, with its extensive range of products. "Nothing is going to be the same as before in the German financial world after this merger", commented the newspaper *Frankfurter Allgemeine Zeitung*. And Charles Calomaris of New York's Columbia University enthused: "Finally, competitive behaviour has come to Germany. The German banks had a mutual monopoly where nobody hurt each other."

Financial press commentators describe the merger as a "concentration of strengths in international competition" with which "maximum cost reduction possibilities and substantial success potentials" can be achieved in the banking sector. British and American experience over the past few years shows that the only banks that are economically viable today are the ones that focus on one core business sector in which they attain global player status. This is "an experience the German banks will also have to go through in the next few years," writes the *Handelsblatt*.

This is why Breuer sees his bank's merger with Dresdner Bank as being merely "a first step in the direction of greater competitiveness and further expansion" in order to attain the required magnitude for planned acquisitions in the American investment banking sector. Rumours have it that one such project is already to be realised within the next two years: the take-over of one of the three leading US investment groupsâ€”Goldman Sachs, Merrill Lynch or Morgan Stanley Dean Witter.

However, despite its huge total assets, the new bank's market capitalisation is still too low. The bank intends to remedy that with profitability increases through cost reductions and the liquidation of hidden reserves by selling off industrial holdings valued at 65 billion marks. "We are a powerhouse, we have the ammo," proclaimed Breuer, outlining the aggressive course the bank intends to follow in the international acquisition stakes.

With that kind of merger, the new bank could well reach the No. 1 position in the US, and create a new dimension of aggressiveness in the international mega-mergers that have been taking place for years now. In 1996 Chemical Banking Corp. and Chase Manhattan Corp. finalised the biggest merger that had ever taken place in the history of US banking. In the same year, Bank of Tokyo and Mitsubishi Bank merged to become the biggest banking group in the world, and in 1997 the United Bank of Switzerland became the biggest bank in Europe. In October 1999, Industrial Bank of Japan, Fuji Bank Ltd. and Dai-Ichi Kangyo Bank Ltd. announced their intention to merge, which would create a new biggest bank in the world.

In Germany the creation of the new mega-bank will set off a wave of bank mergers, greatly accelerating a process that has been developing at a very gradual pace for some time now. Up to now, the only major bank merger was that of Bayrische Vereinsbank and Bayrische Hypotheken- und Wechselbank in 1997, which created Germany's second largest bank, the HypoVereinsbank, and that merger was only realised with great difficulty.

Other merger projects involving Commerzbank AG, BHF-Bank, Bankgesellschaft Berlin AG, Norddeutsche Landesbank and (in that context) Dresdner Bank AG never got beyond the stage of plans and declarations of intent.

The consequences of this development will be very grave for employees in the entire banking sector. The escalating competition, in which the market value of a company has become the sole criterion for survival, leaves no more room for social concessions at the workplace.

Layoffs on a much greater scale than in the new bank will be the order of the day throughout the banking sector. Even the municipal savings banks with their close ties to state and federal government and their government-employee-like working conditions have announced drastic productivity increases in general retail banking. And HypoVereinsbank AG has announced that it will be cutting another 7,000 jobs over the next few years.

Employing the latest technology, the banks are radically reshaping structures in this "dog eat dog" struggle, and, as the newspaper *Die Welt* commented, are even losing in the process their traditional function as accumulation points for capital utilised to finance industry: "The merger mania in the German banking sector is not a sign of burgeoning strengthâ€"it is a symptom of weakness. Contrary to conventional wisdom, the banks are not accumulating powerâ€"they are in the process of losing it. It is no longer the banks that are collecting capital, but rather the stock exchanges, which are combining savers and investors, and distributing the national economy's resources. The population is increasingly becoming an autonomous shareholders' meeting, stripping the banks of their power as intermediaries, operations centres and information pools. 'Who needs banks?' is what the brash New Economy protagonists are saying. And the new banker-speak buzz word is 'dis-intermediation'. Both are dangerous signals."

One consequence is, indeed, the end of "Germany, Incorporated", with its closely intermeshed banks, industry and politics that literally provided the foundation for the entire system of economic and social consensus called "social partnership".

German top management is practically a world of its own. Nearly all of the board members of the German banks also belong to the supervisory boards of the major industrial corporations where, together with politicians and trade union representatives, they perform the ritual of "tough negotiations" that end up in securing social harmony and also bailing out companies that are in trouble.

The latest instance of this was the bail-out of the floundering Holzmann building group last autumn. Anxiety in the banking community that the German federal government might continue this policy of saving companies with subsidies set off an acrimonious debate about Europe's general competitiveness, causing a substantial drop in the exchange rate of the euro to the dollar.

This explains the euphoria in the major business and financial publications which herald the new bank merger as a "thunderclap", a "bolt out of the blue" that will set the path for "long overdue consolidation" in Germany.

The corporate tie-ups and cross-holdings worth nearly 300 billion marks in Germany have become a serious encumbrance for groups such as the Allianz AG insurers, Deutsche Bank AG and the leading reinsurance company MÃ¼nchener RÃ¼ckversicherung AG. They have stakes in nearly all of the major German corporations, yet urgently need the funds tied up in those interests to focus on their respective core business sectors.

Consequently, Allianz AG, which, with 100 billion marks in insurance policy assets in 1999, is the world's largest insurance group and now also one of the largest asset management groups in the world, has announced the successive liquidation of its hidden reserves, valued at 100 billion marks. These reserves are partially tied up in industrial holdings, and are now scheduled to be extracted by means of de-merging, so that they can be used for new acquisitions.

Allianz intends to use these funds to bolster its market lead and pursue the course it has taken more aggressively. In 1999 Allianz purchased the US asset management group Pimco for 4.4 billion marks, and as part of the Deutsche Bank merger deal will take over Deutsche Bank's fund management arm PWS, which is Germany's biggest, and Europe's leading fund management group with total deposit assets of over 150 billion marks.

In the insurance sector, Allianz is already holding buyout negotiations with the US insurance group Pacific Life, and plans to take over a British life insurance group. Allianz is also on the lookout for potential take-over candidates in France.

The industrial corporations caught up in this development have workforces that can range in the tens of thousands. These companies still play an important role in the economy. But they too will be helpless pawns in the stock market merger game if they are not capable of maintaining their stock market value through drastic cost reductions.

It is against this backdrop that the significance of the tax reform drafted by the SPD/Greens coalition government on December 21, 1999 becomes increasingly evident. The abolition of the 50 percent tax on sales profits for joint-stock companies has opened the way for a reorganisation of the German economy that will allow it to become an aggressive global player in the fight for the redistribution of world markets. No longer are hostile foreign take-overs like the buyout of Mannesmann by the British Vodaphone Air Touch group to set the pace. Now the tables are to be turned. It was not without reason that the *Frankfurter Allegemeine Zeitung* demanded that "the political leadership must not rein in this entrepreneurial spirit of initiative".

As in America and Britain, the victims of this development will be the working population on whose backs this fight for market domination will be fought. They will be confronted with an unprecedented proliferation of closures and mass layoffs, a sharp increase in temporary and low-wage employment, and an intensified assault on old-age pensions and the social welfare system.