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Does cross-ownership affect competition? Evidence from the Italian banking industry

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Abstract

The purpose of this paper is to empirically investigate the effects of cross-ownership among Italian banks on competition in the national banking sector. This aim is pursued by measuring and comparing the degree of competition between banks involved in the web of cross-ownership and banks that are not involved. The bank's degree of competition is measured by applying the methodology developed by [Panzar, J.C., Rosse, J.N., 1987. Testing for monopoly equilibrium. Journal of Industrial Economics 35, 443–456.] The econometric results provide empirical evidence that, in the period 1996–2000, Italian banks involved in cross-ownership were less competitive than the other national credit firms, thus supporting the view that cross-ownership may represent an obstacle to industrial competition.
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1. Introduction

In the course of the 1990s, the Italian banking system underwent profound changes at normative and institutional levels, which led – among other things – to a significant relaxation of the entry barriers, to the liberalisation of bank branching, to the redefinition of ownership structure and to a large number of mergers and acquisitions.

The effects of these transformations and, in particular, of those linked to the process of consolidation have been studied by many authors (see, among others: Resti, 1997; Angelini and

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Cetorelli, 2000; Messori, 2001; Sapienza, 2002; Focarelli et al., 2002; Focarelli and Panetta, 2003).

In spite of an increasing interest in the literature, works dedicated to studying the causes and effects of the reorganisation and consolidation processes in the Italian banking system have largely neglected to analyse an issue which is closely tied to such operations: the formation of a complex web of cross-ownership linking the large banking groups in the country, meaning by "cross-ownership" the shares held, directly or indirectly, by the same subjects in more groups.

Generally speaking, the suspicion that cross-ownership among firms may have anticompetitive effects in an industrial sector finds support in the argumentations and in the theoretical results of several contributions in the industrial economics literature. Bruzzone (1999) observes that cross-ownership, in the same way as interlocking directorates, can favour exchanges of practical information which can become collusive strategies among firms. Also Gilo (2000) and Gilo and Spiegel (2003) show that cross-ownership may reduce competition, since they facilitate (tacit) collusion among firms. Maxwell et al. (1999) and O'Brien and Salop (2000) point out that, when major investors own shares in multiple firms in the same industry, cross-ownership changes competitive interest and moves the market equilibrium closer to the monopoly solution.

Regardless of the implications on competition, the issue of cross-ownership among firms is of considerable interest for other reasons. First, cross-ownership can obstruct the contestability and, therefore, the efficient allocation of firms' property rights (for a theory on the efficient allocation of firms' property rights see Hart and Moore, 1990). Secondly, with reference to the Italian banking system, cross-ownership assumes major relevance if one considers that, in many cases, it can be traced down to the main banking foundations, strange beasts that – for several reasons – are unable to guarantee an effective corporate governance of banks (see Messori, 1998, 1999, 2000).

This paper deals with the issue of the effects of cross-ownership on competition. In particular, the aim of the work is to carry out an empirical investigation to assess whether, during the 1990s, cross-ownership among Italian banks had influence on competition in the national banking sector. At the present time, this type of analysis is completely missing in the literature concerning the banking industry in Italy.

The purpose of this study is pursued by measuring and comparing the degree of competition between banks involved in cross-ownership and credit firms that are not involved. The analysis refers to the years 1996–2000, that is to the period in which cross-ownership became an important phenomenon in the Italian banking sector. The bank's degree of competition is measured by applying the methodology developed by Rosse and Panzar (1977) and Panzar and Rosse (1982, 1987) in the context of the so-called New Economic Industrial Organizations (NEIO).

The paper is structured as follows. The next section presents a brief analysis dealing with the issue of cross-ownership in the Italian banking sector. The third section illustrates the strategy of Panzar and Rosse to measure the level of competition in an industry. The fourth section describes the data, the sample and the econometric methodology used in the empirical analysis. The fifth section presents and discusses the main results obtained and the sixth provides some final considerations.

2. Cross-ownership in the Italian banking industry

The formation of a thick web of cross-ownership, which currently connects the main Italian banks, is closely linked to the ongoing process of restructuring of the banking system in Italy.

Over the last 10 years, significant events that have changed the face of the Italian banking industry were primed by the complex normative reform process that started at the beginning of

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