Operating Costs of the Italian Banks

1. The Statistical Sources and the Overall Cost Structure.

1. — In Italy since the war there has been a good deal of talk about the problem of the banks’ expenses, chiefly because it is closely connected with another much discussed problem that is of great importance to the business community: that is to say, the high level of the interest rates charged by the banks for loans to their customers.

During recent years we have already devoted several articles to the subject of banking costs (1). Our object then was to state the main items which make up the total costs of the Italian banks; to compare the post-war conditions with those prevailing before the war; and to describe the current trends.

In the present article we propose to supplement those earlier studies and bring them up to date.

For this purpose the chief difficulty — and to some extent it is insurmountable — lies in the inadequacy of the statistics. In the main these come under two heads:

a) the data published each month by the Bank of Italy in its Statistical Bulletin with regard to the Italian banking system as a whole;

b) the balance sheets of individual banks.

Unfortunately, owing to the way in which the Bank of Italy’s statistics are compiled, they cannot be used for our present purpose (2). We have therefore been obliged to fall back on estimates and assumptions, so that readers should use caution in drawing deductions from the results. These results moreover refer to the banking system as a whole or to the main categories of institutions in it (4); they accordingly conceal the differences between institutions, even though such differences may be great.

2. — In our first article, in 1949, we dealt with 10 banks, and in 1951 the second cover...

(1) The chief reasons why they cannot be used are as follows:
(a) The administrative costs, the interest paid and demand under all heads, are lumped together into a single item called "expenses and losses".
(b) Many banks set off the interest paid on current accounts against the interest received on loans; they set off the discounts paid on bills rediscounted against that received on bills which discount for customers, and so forth.
(c) The items "expenses and losses" as well as the corresponding item on the side of receipts, appears only as from the end of 1943 onwards. The 1938 statistics on the other hand indicate only the usual net profit for the past four, or losses if any. This makes comparison impossible.
(d) A study of the three banks of national interest revealed that for 1949 and 1950 the Bank of Italy’s official statistics showed a profit of 53,252 million and a loss of 34,450 million, whereas the profit and losses of the three banks in question showed these items at 31,604 million and 37,652 million respectively. No explanation of these substantial differences could be found.
(e) Italian banks send to the Bank of Italy quarterly statements which are drawn up on uniform lines, but these statements are not available to the public.
(f) A Public Law Credit Institution (fiere); a Bank of national interest (banche) private companies or firms; credit cooperatives; and savings banks.

...
ed 24. This time we deal with 50, including all the 24 previously discussed, and for all 50 we have obtained the full set of balance sheets from 1937 to 1953. The sample is made up as follows:

- 5 «public law credit institutions», being all that exist in this class (Banca Nazionale del Lavoro, Banco di Napoli, Banco di Sicilia, Istituto S. Paolo di Torino, Monte dei Paschi di Siena);
- 3 «banks of national interest», these too being all that exist (Banca Commerciale Italiana, Credito Italiano, Banco di Roma);
- 17 banks incorporated as companies or private firms, whose total assets at the end of 1953 represented 67% of those of all banks in this category;
- 12 credit cooperatives, with total assets representing 79% of those belonging to such institutions at the end of 1953;
- 13 savings banks, with total assets representing 55% of those of all savings banks.

Taken together, the 50 banks at the end of 1953 held 83% of all deposits and current accounts in lire in the Italian banking system. But owing to the differences of arrangement already mentioned it was unfortunately not always possible to add together corresponding items from the balance sheets of all of them. That could be done only where the figures in the balance sheets of the various banks were found to show certain categories of expenditure in a sufficiently uniform manner (5).

3. — We propose in the present study to classify the Italian banks' costs as follows:

**I. Administrative expenses (or operating costs):**
- expenditure on personnel, social security, pensions, grants, etc.;
- taxes;
- losses, amounts written off, applied to depreciation, etc.;
- sundry expenses.

**II. Interest paid:**
- on saving deposits;
- on current accounts.

The general breakdown of banking costs is summarised in Table I. The percentage ratios there shown make it possible to point out in a general way several significant aspects of the matter, even though there are so many gaps in the statistics that the results cannot be regarded as indicating anything more than tendencies.

Among the items making up bank costs in 1938 the largest share, of 29%, was taken by interest on saving deposits. Next came expenditure on personnel with 24%, sundry expenses 15%, interest on current accounts 13%, amounts written off 10% and taxes 9%. By 1948, after war and inflation, the situation had radically changed. Interest on saving deposits had dropped to the modest level of 6%, while the expenditure on personnel alone took 50%, being followed a long way behind by depreciation at 13%. The interest on current accounts had also fallen from 13% to 6%.

From 1948 onwards, in the new conditions of stable currency, a better balanced pattern began to emerge. The expenditure on personnel, although keeping first place, steadily dropped to 42% of the total costs in 1953. Meanwhile the interest on current accounts rose considerably, reaching 20% of total costs in 1953 as against only 6% in 1948 and 13% in 1948.

Total interest paid, after falling from 41% in 1938 to 12% in 1948, was up to 39% again in 1953. Meanwhile the administrative costs, after going up from 5% in 1938 to 8% in 1948, steadily fell to 7% in 1953. But the ratio of these costs to the total still remains higher than before the war, mainly because of the rise in cost of personnel, even though the average rates of interest paid on saving deposits and current accounts rose, as a separate item, that paid on current accounts, in 1953 made it impossible to set the amount of interest paid even on saving deposits, including interest in items adversely described, or even lumped together with discount paid, interest paid on advances and loans received, or brokerage and commission paid, as well as in some cases with interest paid on current accounts. A fuller breakdown regularly shows the interest paid on current accounts, but such items are not considered in the statistics, so that there is ground for supposing that they may have offset the interest paid on current accounts against the interest received on lendings to customers.

As regards administrative expenses the figures given in the text are based on the statements of banks in the various groups as follows:

<table>
<thead>
<tr>
<th>Bank categories</th>
<th>Number of banks considered</th>
<th>Savings banks, lire</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Law Credit Institutions</td>
<td>5</td>
<td>1</td>
</tr>
<tr>
<td>Banks of National Interest</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Ordinary Credit Banks</td>
<td>17</td>
<td>5</td>
</tr>
<tr>
<td>People's Cooperatives</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Savings Banks</td>
<td>12</td>
<td>3</td>
</tr>
<tr>
<td>Total</td>
<td>50</td>
<td>19</td>
</tr>
<tr>
<td>Operating costs (in 1953)</td>
<td>22,351</td>
<td>3,642,660</td>
</tr>
<tr>
<td>% ratio</td>
<td>100</td>
<td>1.77</td>
</tr>
</tbody>
</table>
felled to 60% in 1953. Taxes would appear to have declined from 17% in 1958 to 13% in 1958 and then rise to 29% in 1953. A noteworthy relative decrease seems to have occurred in the "losses, amounts written off, and applied to depreciation", which dropped from 17% in 1958 to 13% in 1949 and 10% in 1953. A warning must however be given that this item is of highly doubtful significance, and the percentages relating to it should be treated with great caution. It probably overlaps with the "sundry expenses", since the combined percentage for the two items shows remarkable steadiness.

Let us now try to arrive at the cost for the banking system as a whole, and for the five main groups which make it up (2) - of administering too lire of deposits or of resources in any other form.

To do this we need to know the absolute amount of the operating costs of the funds administered, in each group of banks. The absolute figures for administrative expenses are given in Table III, which is an extension of Table II. As for the other element in the ratio, namely the funds administered, one could take:

a) lire saving deposits and current accounts;

b) total assets - of course greater than a; or

c) total assets plus acceptances for account of customers, guarantees given for customers, and confirmed credits opened; or

d) the amount of a) plus that given in the statistics for customers' securities held in safe custody.

If the ratios between a), b), c) and d) were constant over a period of time, then use of any one of the four would merely shift in equal proportion the percentage ratios which we are going to calculate. But in fact those ratios vary not only between groups of banks, but also from year to year between banks in the group.

What is more, the banks' business is not confined to collect money on time deposit and current account and lending it out, they render sundry services, recorded in the balance sheets under separate headings. One need only think of foreign exchange business, collections, accommodation by way of endorsement and so forth. For these reasons it appears best to take c). However, in view of the prominent importance of time deposits and current accounts, we have also worked out the ratio of administrative expenses to these.

<table>
<thead>
<tr>
<th>Year</th>
<th>Operating costs</th>
<th>Deposits and current accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Millions of lire</td>
<td>Index (1958 = 100)</td>
</tr>
<tr>
<td>1949</td>
<td>1,244</td>
<td>56.5%</td>
</tr>
<tr>
<td>1950</td>
<td>1,219</td>
<td>55.7%</td>
</tr>
<tr>
<td>1951</td>
<td>1,467</td>
<td>54.6%</td>
</tr>
<tr>
<td>1952</td>
<td>1,574</td>
<td>52.8%</td>
</tr>
<tr>
<td>1953</td>
<td>1,592</td>
<td>53.0%</td>
</tr>
</tbody>
</table>

We have thus calculated for each category of banks the ratio between total assets and total deposit and current accounts, each as annual averages (Table IV). The object is to show to what extent the banks in each category do business which goes beyond simply employing deposits (8). Clearly the indication thus obtained is valid only in so far as the banks' subsidiary activities give rise to entries in their balance sheets.

6. The figures in Tables III and IV make it possible to express the Italian banks' operating costs of the Italian banks.

(2) As will be seen from Table IV, at the "public law credit institutions" and at the "banks of national interest" the subsidiary activities showed a noteworthy increase in extent after the war as compared with 1938. This tendency became less pronounced during the last two years (1951-53), more so at the public law credit institutions (which returned almost to the pre-war rate of affairs in this respect) than at the banks of national interest.

In the other categories of banks the variations in the ratios were smaller. Between 1949 and 1953 the ratio of total assets to deposits and current accounts for banks in the form of limited companies fell from 1.47 to 1.36, that for credit cooperatives dropped from 1.46 to 1.34; and that for savings banks rose from 1.29 to 1.37.
operating costs in per cent both of their deposits and of their total assets. The result of doing so is given in Table V.

As will be seen, for every 100 lire of total assets the banks in 1953 incurred administrative expenses amounting to 3.6 lire as against 2.2 lire in 1958. On every 100 lire of deposits and current accounts the charge for administrative expenses was 5.6 lire in 1953 as compared with 3.3 lire in 1958. The maximum level would seem to have been reached in 1948, when the expense ratio was 5.5% and 7.0% respectively on the two bases. Between 1948 and 1953 there was thus considerable improvement, reflecting the efforts made by banks to achieve greater efficiency and productivity. Between those two years the reduction in costs would seem to have reached 28% to 39% for the banking system as a whole, with peaks of 33% for "public law credit institutions" and "banks of national interest" and an average of 24% for the other categories.

This return towards pre-war conditions represents a movement towards a better balanced pattern. The increasing rate of remuneration offered from 1948 to 1953 on deposits and current accounts was made possible by the relative decline in operating costs.

7. We have already pointed out the great relative importance of expenditure on personnel since the war. The growth in this item results partly from the rise in salaries which, even in real terms, would seem on the average to have exceeded the devaluation of the currency. But it is due still more to the increase in the total staff employed from 53,600 in 1948 to 95,000 in 1953. This increase in turn largely reflects the changed conditions which have made banking work more complex, laborious and intricate. This is not the place to enter into a detailed analysis of these factors. We must confine ourselves to pointing out some further principal causes of what occurred.

First of all, many departments are now carrying a much heavier burden of clerical work in connection with new services of a public nature for which the banks have been made responsible, such as the foreign exchange regulation, the administration of import and export controls (and furthermore the volume of Italian foreign trade has grown considerably larger as compared to prewar), etc.

In the second place, the rôle of Italian banks as accountkeepers for the community is now much more important than it used to be before the War (19). The range of banking services made available to the public has become broader and more diversified, while the number of bank customers has increased substantially. In other words, in Italy today, the function of the banks as "lender clerks" for the whole community has increased in importance as compared to the traditional function of "capital intermediaries".

In the third place, there is a series of maladjustments connected with the devaluation of the lira (to be discussed more thoroughly in para. 11 below), including:

- the inadequate adjustment of the average value of each transaction to the process of monetary devaluation (11). This increases the book-keeping work and the number of accounting entries;
- more work is entailed in handling and holding cash because the denominations of bank notes have not been increased enough to correspond to the devaluation of the lira;
- for the same reason more work is required for handling and holding securities in the form of shares, Government and other bonds and the coupons belonging to them;
- the clerical and accounting work is increased by the need to write numbers with more digits to express the same real values as in 1938. This difficulty has now been partly overcome by dropping the centesimi and showing amounts to the nearest lira.

Lastly, we should mention the increased number of bank branches from 7,384 in 1938 to 7,874 in 1953.

(19) In this respect, the expansion of current accounts and clubber cheques is highly significant. The former increased 31 times from 1948 to 1953 (owing deposits having increased only 33 times); the latter increased 39 times (and of year figures).
(20) That is to say the average size of each savings bank book, with current account, each insured or withdrawable payment, each bill discounted or collected, each circular cheque, the average per value of each security representing bonds or shares, etc.
The increase in the number of bank employees has caused a reduction in the amount of funds administered per employee. In 1953 there were 93,000 members of bank staffs administering 3,551 billion lire of deposits and current accounts, whereas in 1938 there were 53,000 administering 3,108 billion lire (see with 1938 purchases, !power). The corresponding figures for average total assets were 5,501 billion in 1953 and 4,498 billion in 1938. Thus the average amounts handled per employee were 58 and 58 million lire in 1953, as against 58.6 and 44.7 million in 1938 (12).

III. Cost of Interest Paid on Deposits and Current Accounts; Total Costs.

8. — It is more difficult to investigate the pattern and the amount of the expenditure on interest, more particularly the interest on current accounts (13). Indeed, the cost of interest on current accounts is the really unknown element in an attempt to arrive at a statistical basis — at the probable composition of costs in the Italian banking system.

As has already been stated in footnote 5, only 10 of the 90 banks considered (14) show in their published statements what they paid out in interest on current accounts separately.

(13) The actual amounts for 1958 have been multiplied by 3.5, being the wholesale price index for 1958 on the basis of 1954-55, as to convert them into 1954 lire.
(14) In Italy, debts (minimum) and credit (maximum) banks' interest rates are fixed by the so-called 'pricing chart'.
9. — The average level of the rate of interest now paid on deposits and current accounts as a whole is not shown in the available statistics, nor can it be calculated therefrom. The best that can be done is to estimate the rate. It is put at 2.50% for the whole banking system in 1953. If it is borne in mind that for 1950 we put the average rate between total costs and funds administered for the individual groups of banks and the banking system as a whole in 1933. It will be seen that for each 100 lire of total assets administered the banks in that year had expenses of 5.4 lire, while on each 100 lire of deposits and current accounts the charge was 8 lire.

### TABLE VI

<table>
<thead>
<tr>
<th>Administrative Banks</th>
<th>Total costs</th>
<th>% Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deposits and Current Accounts</td>
<td>Total assets</td>
<td>Credit interest</td>
</tr>
<tr>
<td>Public Law Credit Institutes</td>
<td>169,0</td>
<td>1,129,4</td>
</tr>
<tr>
<td>Banks of National Interest</td>
<td>52,5</td>
<td>1,141,7</td>
</tr>
<tr>
<td>Ordinary Credit Banks</td>
<td>79,1</td>
<td>1,024,7</td>
</tr>
<tr>
<td>People's Cooperative Banks</td>
<td>57,0</td>
<td>617,5</td>
</tr>
<tr>
<td>Savings Banks</td>
<td>79,3</td>
<td>594,6</td>
</tr>
<tr>
<td>Total</td>
<td>531,4</td>
<td>4,991,3</td>
</tr>
<tr>
<td>Percentage distribution</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

These ratios, however, are to be taken with considerable caution. It should not be inferred therefrom that the banks, in order to break even, must obtain from their assets an average gross profit of not less than 5.4%. The average return from total assets (and it should not be forgotten that this is an average derived from widely diversified elements, including non-interest-bearing items and items yielding little interest) can be somewhat lower, because an overall calculation of receipts should include all monies received by the banks from the so-called "subsidiary services." The latter have acquired increasing importance in the last few years, and not always do they result in entries in the balance sheets of the banks.

### IV - Prospects for Bank Costs.

11. — During the first few years after the war the growth of bank costs seemed closely connected with inflation and the related contraction in total deposits and current accounts expressed in real terms. This aspect of the matter tended to overshadow all the other factors which also went to swell the bank's administrative expenses. But those factors became apparent when the fog of inflation cleared, and total saving deposits and current accounts finally stabilized and then exceeded the 1998 figure in terms of real values.

Evidently, if the banks' deposits keep on growing to a considerable extent, their operating costs ought to feel the benefit. Indeed, the hope that the ratio of costs to funds administered can be further appreciably reduced is mainly based on that expectation. Yet nobody can at the moment foresee how fast the deposits and current accounts will grow. Nor would it be safe to extrapolate the curve as found for the years 1928 to 1953, which would indicate growth at an average annual rate of about 20%.

Apart from growth in the total of deposits and current accounts, the possibility of further reducing bank costs depends on a number of conditions relating to organisation and technical methods. While these may in the aggregate be of considerable importance, the banks are in many cases unable to change them. Let us recapitulate:

In paragraph 7 we pointed out that bank note denominations had not been raised to accord with the devaluation of the currency (19). On 30th September, 1951 a million lire note was introduced, a process which, in view of the average 750 notes for every million present-day lire, means that each bank had to increase its average stock of notes by about 100%.

(19) On 26th December, 1950, there was in circulation 355,000 million lire of denominations ranging from 1 to 5,000 lire and amounting to a total value of about 175 billion lire. On the average basis, therefore, 2,400 lire notes were required to make up each million lire.

On 1st December, 1951, there were in circulation 450,000 million lire of denominations ranging from 5 to 5,000 lire, amounting to a total value of about 165 billion lire. Accordingly, 1,600 lire notes were required to make up every million lire. The notes for 25 and 100 lire have become more common, but must be included in the calculation so as to keep the basis the same. On 31st December, 1951 they numbered at least 900 million, their total value being about 230 billion lire. At that date, therefore, there were about 1.4 million notes in circulation, to a total value of 1.48 billion lire. For each denomination the number has increased by about 300%.

The parity value of each million lire in 1928 was 1.50 lire, as it has always been. The securities comprising Governments consolidated and redeemable debt have not been subjected to any great changes. Only in the case of the 3.5% redemption bonds do the securities have been transformed into new issues of a par value of 2.50 lire each, while a similar transformation is contemplated for the 3.5% notes of 1925 and 1926.

In the case of Treasury Bills the par value of each security has been raised from 5 to 2.50 lire in the most recent issues.

The par value of bonds of companies and public institutions
C) Moreover, the average value of each bank transaction of the common types is also too low in view of the devaluation of the currency; but it seems fair to suppose that the market does not feel the need for an all-around evaluation. Let us make this point a little clearer:

(1) From certain incomplete statistical records of investigation it would seem that only the denominations of circular cheques and of the cheques issued by the Central Institution for Savings Banks are on the average as large as they were before the war. But it would also seem reasonable to suppose that this results merely from the wide use of cheques of high denomination, say of 3 to 5 million lire each, and not from any increase worth mentioning in the amount of the cheques issued each year as a whole.

(2) Nor has there been an adequate rise in the average size of saving deposits and balances on current account. Their number on 31st December, 1953 was extremely high at 19,247,241; and this fact helped to increase operating costs. It has been suggested that the number of deposit accounts is actually much larger than the number of depositors. This suggestion is based partly on knowledge of depositors' habits, and is supported by the fact that active customers of the banks at the end of 1953 numbered only 2,146,875. It is therefore to be hoped that the banks may devise some means of substantially reducing the number of their deposit accounts, with a corresponding reduction in costs.

(3) Even more intractable, if one may judge from the scanty data collected, is the problem of bills of exchange. The average amount of the individual bill would seem to have remained ever since 1948 at around 37 times what it was in 1938.

D) Finally, certain other statistics which have been collected suggest that the period which elapses between each banking transaction and the next one of the same kind grew shorter between 1948 and 1953. This again means a relative increase of work for the banks.

To conclude, if the ratio of bank costs to administered funds is to be brought down further, then the growth of deposits which has occurred during recent years must continue, while any increase in costs must be kept within narrow limits. Further, the average size of each transaction must be made to accord better with the reduced value of the currency; the many hindrances and restrictions must be removed or made less irksome; and the banks must be tireless in rearranging and improving their own organization and accounting systems. Finally, competition among the banks must not prevent an agreement to fix deposit rates on a sound basis, reconciling the need to increase banking resources with the equal need to keep the cost of bank loans within such limits that they can be borne by borrowers.

12. — There can be no doubt that bank costs still remain relatively high, mainly because of the heavy burden of expenditure on personnel. And yet, if the facts are realistically considered, it must be said that between 1948 and 1953 operating costs were steadily reduced by a considerable margin in relation to total deposits. The average amount of funds administered per employee has risen; the banks have done much to rationalize their work and improve productivity; and these facts together have produced considerable results. One result was to make it easier to pay higher rates of interest to holders of saving deposits and current accounts in the way that has been several times mentioned.